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A PRACTICAL GUIDE TO
ACCOUNTS FOR COMPANY SECRETARIES
AND SECRETARIAL STUDENTS

BY

H. E. COLESWORTHY, A.S.A.A.

GOLD MEDALLIST OF THE SOCIETY OF INCORPORATED
ACCOUNTANTS AND AUDITORS
AUTHOR OF "PRACTICAL DIRECTORSHIP"

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PREFACE

During comparatively recent years the business world has witnessed an extraordinary change which has crept over the profession of the company secretary. It has seen the gradual eclipse of the old-fashioned secretary whose abilities were often confined to dignified letter-writing; it has seen the rise of the professional secretary whose accomplishments fit him for the post of chief officer to joint-stock companies. The change is now so complete that the company secretary is expected to be a first-rate accountant as well as secretary, and an expert in as much mercantile law as may be expected of any layman. In addition, he is expected to be equipped to meet most of the demands which may be made upon him in connection with economic questions, taxation, and the higher problems of joint-stock finance, which form so important a part of modern mergers and the movements which are going on towards rationalization of industry.

It goes without saying that the credit for the change referred to is due entirely to the professional secretarial bodies. In the face of great difficulties, they have succeeded in raising the status of the company secretary to a degree that would have seemed impossible a generation ago. They have set a standard for their members which permits the business community to expect from the company secretary the highest possible attainments in every branch of commercial knowledge.

Not the least important of these attainments of the secretary is his sound knowledge of accountancy. In fact, one might almost go so far as to say that it is the most important part of his equipment. The truth of this becomes very evident in any review of a company secretary's functions. Such a review shows clearly that

" accounting " for his company's funds is the mainspring of practically every one of the secretary's activities.

It must be admitted that accountancy knowledge has not always been the most predominant of the secretary's accomplishments. There has, in fact, been somewhat of a readiness in the past for the secretary to turn to the auditor for the solution of difficult accountancy problems. This state of affairs, however, is rapidly passing away, and the secretary is inclining less and less to call in his company's auditors for the performance of purely accountancy work.

The only trace of this former state of affairs now remaining reveals itself in occasional excuses for delayed accounts made by chairmen of companies saddled with unqualified and inefficient secretaries. Such chairmen usually seek to explain the delay on the grounds that " the auditors have not yet completed the preparation of the Balance Sheet." No efficient secretary would ever give his chairman ground for making such a statement.

The state of affairs referred to above is, happily, rare. In the cases in which it occurs it will be found that it arises only in connection with the final accountancy work which immediately precedes the preparation of the Balance Sheet. As far as the ordinary book-keeping of a company is concerned, there is hardly ever cause for complaint. The routine entering of transactions in Sales and Purchase Ledgers, or the recording of cash payments and receipts, proceeds without trouble. For this reason, the present volume does not deal in great detail with the elementary routine of simple book-keeping entries. It is to the accountancy aspect of a secretary's duties that most attention will be directed. The distinction is explained below.

The secretary's duties as an accountant are extremely varied. He is expected to direct the whole of the routine

work of his book-keepers. Then he is responsible personally for the accountancy work which is necessary at the end of each financial year. This includes the preparation of draft accounts, the completion of the final accounts, and the passing of the closing entries. Included in these duties is the accountancy work connected with service agreements, royalty agreements, management agreements, and the calculation of depreciation, depreciation funds, sinking funds, and amortization of leases. In many cases, also, there is the advisory and constructive accountancy which falls upon the secretary, whose board of directors rely upon him entirely for the preparation of their accounts for presentation to shareholders.

Finally, every secretary must be capable of carrying out or supervising the additional or extra accountancy which may crop up at irregular intervals during the course of the year. This includes the accounting work in respect of such matters as joint ventures, hire-purchase agreements, and consignment accounts. It includes the supervision and installation of "self-balancing" systems, and the incorporation of foreign branch accounts. It covers also the entries connected with issues of share capital and debentures, bonus issues of shares, and occasionally the reduction of capital.

These illustrations of a secretary's duties may seem to comprise a formidable list, particularly when it has to be emphasized that they are representative only. The only difficult phases of the secretary's accountancy duties are, in fact, those which cannot be designated by specific classification. The list given above can, therefore, only be regarded as illustrative. In spite of this, however, the reader has no need to lose heart, for we can assure him that no item in the list is insurmountable. If the simplicity of the principles is grasped, then the apparent difficulty which arises from the

involved titles given to the accounts will be speedily overcome. It may be thought that it is an absurd convention to give high-sounding titles to every phase of higher accountancy. The practice is of some value, however, for it definitely classifies a series of entries, and standardizes the method of dealing with each particular matter. On the other hand, it must be admitted that it tends to alarm the student who reads into the title much more than it is really intended to convey. We can only repeat that no accountancy problem is insurmountable, provided the secretary who has to tackle it is endowed with initiative and common sense.

A final point to be remembered—and it is emphasized throughout this book—is that the everyday problem of accountancy is usually encountered by the secretary in a form which prevents it from being easily recognized. For example, the directors of a company would scarcely ask the secretary to " solve the following problems in current accounts involving red ink interest." Neither would the secretary be given a royalty account with detailed instructions as to the opening of a " Short Workings Account." What happens in actual practice is that as soon as a royalty agreement has been approved by a board of directors, the secretary proceeds with the necessary accountancy work entirely on his own initiative. This means that he has to study the agreement, grasp the significance of each clause, and open up accounts which will give effect to each aspect of the transaction. He cannot work by rule of thumb—he must draw on his own intelligence.

This procedure is identical in every type of account. The secretary can be successful in everyday practice only if he puzzles out the principle underlying each problem. In no case can he record transactions by attempting to apply rules blindly. He must first understand very clearly what he is about to do.

The present volume has been compiled entirely on

the principles outlined above. Instead of a dogmatic exposition of rigid accountancy rules governing each class of account, it seeks first of all to draw out the reader's own initiative. An attempt is made, in every case, to lead him logically along the path he would tread in actual practice. The reason for each step is considered, and then emphasized, and no effort is made to stress the orthodox method of dealing with any problem until the logic of the process is established.

Finally, it is repeated that the formidable appearance of some of the titles of types of account are forced into proper perspective. This is brought about in two ways: firstly, the simplicity of certain accounts is emphasized before the reason for their title is considered; in the second place, the elementary nature of one or two types of account, usually treated towards the end of standard textbooks, is here emphasized by their incorporation in the text at an early stage.

H. E. C.

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SECRETARIAL BOOK-KEEPING AND ACCOUNTS

SECTION I
DOUBLE ENTRY PRINCIPLES

CHAPTER I

DEFINITIONS AND ELEMENTARY PRINCIPLES

THERE is only one system of book-keeping in use in England to-day, and that is the Double Entry System. Wherever this system is not in use, then no satisfactory alternative will be found in its place; it is still possible to find sole traders, and occasionally partnerships, with books which are not maintained on Double Entry System. In referring to their book-keeping it is customary to say that they follow the "Single Entry System," but this should not lead the student to suppose that such traders and firms are following an alternative or a definite system of book-keeping. Whenever books are kept in a slovenly fashion, without full regard to double entry principles, then it is said that they are kept on a "Single Entry System."

It is the object of this book to clear away, as far as possible, the confusion which surrounds accountancy —and particularly accountancy nomenclature. We start, therefore, with the reassuring statement given above to the effect that there is only one system of book-keeping. The truth of this statement will be emphasized later on, particularly when the reader finds

that " The Slip System of Book-keeping," for example, turns out not to be a system at all. Types of account such as this will resolve themselves, on close examination, into nothing more than slight variations in the methods of applying the principles of the one system of book-keeping—the " Double Entry System."

The Double Entry System.

Each commercial transaction has two aspects. There are always two parties—the giver and the receiver—and in every transaction, therefore, it is possible to identify two aspects by asking oneself—

(*a*) Which person is the payer in this transaction —or which account suffers?

(*b*) Which person or account benefits by this transaction?

The fact that these two aspects are present in every possible transaction is the basis of double entry book-keeping. The first exponents of the system—the chief of whom was a monk named Pacioli—recognized the significance of the two-sided aspect of each commercial transaction. These originators laid it down that both aspects should be recorded in the books of account; in other words, that there should be a *double entry* in the books for each transaction.

Debit and Credit.

In order to distinguish between the two entries, the aspect relating to the receiving is entered on the left-hand side of the book of account, and the giving aspect is entered on the right-hand side. To distinguish between the two sides the left is known as the debit, and the right as the credit, abbreviated in practice to " Dr." and " Cr."

The Check Provided by Double Entry.

The reader will probably be quite familiar with this

preliminary matter, but the inexperienced student should re-read the foregoing paragraphs very thoroughly. It will be clear that if every entry is made twice, once on the debit side and once on the credit side in the books of account, the total of the debits must always equal the credits. There is thus demonstrated one of the advantages of the double entry system—a check on arithmetical accuracy is always provided, for unless the debits equal the credits a clerical error must have been made in one or more of the entries.

The Book of Account.

In subsequent chapters will be found a description of the books used in double entry book-keeping. At this point, however, the reader can be informed that only one of the books which will be described is *essential* to double entry book-keeping. The indispensable book is the Ledger, and every other book is either a subsidiary book or a book of memoranda which could, if desired, be dispensed with. In practice, of course, no business dispenses with all subsidiary books, but the number in use varies very considerably with the particular requirements of each undertaking.

The statement that there is only one essential book of account may seem incredible to those whose experience has led them to regard Cash Books and Journals as indispensable. It is perfectly correct, however, and it will assist us in our task of dispelling the mystery in which book-keeping is enveloped if the reader will keep the fact always before him.

The book of account, the Ledger, is ruled so as to distinguish clearly between the left-hand side (the *Dr.*) and the right-hand side (the *Cr.*). Illustrations are given on the next three pages taken from the Ledger of a Mr. James, who we will assume is a Merchant.

Illustrations of Ledger Rulings

PURCHASES ACCOUNT

Folio 9

Dr. *Cr.*

193..		*Fo.*	£	*s.*	*d.*	193..		*Fo.*	£	*s.*	*d.*
Jan. 1	To Sundries . . .	12	50	–	–	Feb. 1	By Allowance . .	12	10	–	–

JOHN ROBINSON

Folio 12

Dr. *Cr.*

193..		*Fo.*	£	*s.*	*d.*	193..		*Fo.*	£	*s.*	*d.*
Feb. 1	To Allowance . .	9	10	–	–	Jan. 1	By Purchases . .	9	50	–	–
Mar. 1	,, Cash . . .	1	30	–	–						
,, 1	,, Balance . . .	c/d	10	–	–						
			£50	–	–				£50	–	–
						Mar. 1	By Balance . . .	b/d	10	–	–

CASH

Folio 1

Dr.												*Cr.*
193..		*Fo.*	£	*s.*	*d.*	193..		*Fo.*	£	*s.*	*d.*
Jan. 1	To Capital introduced into Business	3	100	–	–	Feb. 1	By Furniture	34	20	–	–
Mar. 1	,, W. Allen	10	20	–	–		,, J. Robinson	12	30	–	–
							,, Wages	16	10	–	–

W. ALLEN

Folio 10

Dr.												*Cr.*
193..		*Fo.*	£	*s.*	*d.*	193..		*Fo.*	£	*s.*	*d.*
Feb. 1	To Sales	23	40	–	–	Mar. 1	By Cash	1	20	–	–

SALES ACCOUNT

Folio 23

Dr.												*Cr.*
193..		*Fo.*	£	*s.*	*d.*	193..		*Fo.*	£	*s.*	*d.*
						Feb. 1	By Sundries	10	40	–	–

FURNITURE ACCOUNT

Dr. *Cr.*

193..		Fo.	£	s.	d.	193..		Fo.	£	s.	d.
Feb. 1	To Cash . . .	1	20	–	–						

CAPITAL ACCOUNT (B. JAMES)

Folio 3

Dr. *Cr.*

193..		Fo.	£	s.	d.	193..		Fo.	£	s.	d.
						Jan. 1	By Capital at this date .	1	100	–	–

WAGES ACCOUNT

Folio 16

Dr. *Cr.*

193..		Fo.	£	s.	d.	193..		Fo.	£	s.	d.
Mar. 1	To Cash . . .	1	10	–	–						

Analysis of Ledger Accounts.

At this point the reader should take each of the entries included in the above illustrations, and trace through the corresponding debit or credit for each one. This may take a little time, but the effort will be well repaid. As each corresponding debit and credit are identified they should be listed. Then the question should be applied to each: " Which person or account is the giver and which is the receiver; or which person or account suffers or benefits by this transaction? " The answer will give the key to each entry.

The results when listed will appear as shown on page 8.

The analysis of each account should follow on the lines shown on page 8, and as soon as the list is completed the following paragraphs should be studied.

Main Classification of Ledger Accounts.

Everything that has preceded this paragraph has been based upon ordinary reasoning only. It has not been necessary to use any technical terms, or to resort to involved accountancy terminology. If the student has carried out the analysis of the specimen Ledger Accounts, however, he will have perceived differences in their nature. He cannot have failed to notice that they could all be classified either as Personal Accounts, i.e. relating to the persons with whom Mr. James deals, or as Impersonal Accounts, i.e. recording the impersonal side of the various transactions. These two classifications—" Personal Accounts " and " Impersonal Accounts "—must be remembered by the student. Were he to proceed with the entering up of Mr. James's ledger for a whole year, he would find this difference asserting itself continually. He would find that although so apparently different from one another, *every* account with which he deals would fall into one or other of the two main classifications specified. This rule holds good

In next edition - revise wording - the argument is not clear.

	Transaction	Observation
1. Purchases (Debit) £50 and John Robinson (Credit) £50.	A purchase by Mr. James's Purchases Account from J. Robinson.	The Receiving Account is debited and the Giving Account is credited.
2. Purchases Account credited with £10 for an allowance and John Robinson debited £10.	John Robinson's Account is settled, in part, by the Credit Note of £10, which is deducted from the price of his goods. Mr. James's outlay in the purchase of goods is reduced to a like extent.	Purchases Account benefits by a reduction in the price of goods supplied by Robinson and is therefore credited; John Robinson receives part settlement of his debt and is therefore debited. This may appear somewhat involved, but it becomes clearer if it is realized that Robinson receives settlement of his account as to £10 in the form of a deduction in his bill and as to £30 in cash. (The balance of £10 is " carried forward.")

throughout double entry book-keeping, and it is subject to no exception.

Subdivision of Personal Accounts.

The Personal Accounts will now be found to fall into a further subdivision. They are all either *Debtor Accounts* or *Creditor Accounts*. A debtor is a person who owes money to Mr. James, e.g. Mr. Allen in the illustrations. A creditor is a person to whom Mr. James owes money, e.g. Mr. Robinson.

Subdivision of Impersonal Accounts.

A further study of the illustrations will show that all the Impersonal Accounts (i.e. all the accounts except those relating to Messrs. Robinson and Allen) also lend themselves to a further subdivision. They record either *Real* items, such as furniture or cash, which are real and tangible, or they record *Nominal* items, such as wages, purchases, or sales which are intangible.

The foregoing paragraphs record the only divisions of accounts with which the reader need concern himself. There are, however, two terms or names of accounts with which he must be familiar, namely, "Assets" and "Liabilities."

Assets and Liabilities.

"Assets" are the possessions or the property of a business. "Liabilities" are the commitments or debts due by a business to its creditors. If reference is made once more to the illustrations, it will be found that of the debit balances or debtor accounts, those which do not represent expenses or losses are "Assets." On the other hand, the credit balances or accounts which do not represent income or profit relate to "Liabilities." It follows from this that all debits are either losses or assets, and that all credits are liabilities or profits.

Identification of Accounts.

So far we have used as a basis for our explanations the very limited number of Ledger Accounts which have been given as illustrations. The limitation of the number was intentional, as it permitted us to demonstrate that the classification of accounts is not involved in the least. It was possible to illustrate the full division of Ledger Accounts by means of eight examples only. We may now proceed to demonstrate that *every* Ledger Account which the reader will ever encounter may be classified immediately, provided the principles governing those eight examples have been grasped.

The demonstration can best be made by setting down the name of the accounts which one could expect to find in the ledger of Mr. James, who we will assume is a garage proprietor. Against each account will be given its classification, which may be checked by reference to the illustrations we have already given.

The list, which is given on pages 11 and 12, could, of course, be continued indefinitely, but it is probably of sufficient length to illustrate finally the points with which we have dealt. The reader should now be in a position to compile such analyses for himself from any list of Ledger Accounts laid before him. We will conclude this chapter with a table of the rules which govern all entries in Ledgers. This table is usually given first in book-keeping treatises with instructions that it should be memorized. As, however, we have dealt fully with the reason for each rule and with the principles governing them, it should be found that it does not require memorizing. It should serve merely as a tabulation of the method of identifying and classifying every book-keeping account at sight.

Table of Rules.

1. All Ledger Accounts are either Personal or Impersonal Accounts.

2. All Impersonal Accounts are either real or nominal.

(*a*) PROPERTY AND POSSESSIONS WITH WHICH MR. JAMES COMMENCES BUSINESS

Account	Debit or Credit	Asset or Liability	Expense or Income	Personal or Impersonal	If Impersonal, whether Real or Nominal	Remarks
1. Cash at Bank	Debit	Asset	—	Impersonal	Real	
or Overdraft due to Lloyds Bank, Ltd.	Credit	Liability	—	Personal	—	
2. Stock	Debit	Asset	—	Impersonal	Real	
3. Buildings	Debit	Asset	—	Impersonal	Real	
4. Loan from W. Thomas	Credit	Liability	—	Personal	—	Money borrowed from friend.
5. Goodwill	Debit	Asset	—	Impersonal	Real	Paid when acquiring the business.

(*b*) ACCOUNTS RELATING TO TRANSACTIONS AFTER COMMENCEMENT OF BUSINESS

Account	Debit or Credit	Asset or Liability	Expense or Income	Personal or Impersonal	Real or Nominal	Remarks
6. Purchases	Debit	—	Expense	Impersonal	Nominal	
7. Sales	Credit	—	Income	Impersonal	Nominal	
8. Purchase Returns	Credit	—	Income	Impersonal	Nominal	
9. Sales Returns	Debit	—	Expense	Impersonal	Nominal	
10. A. Jones	Debit	Asset	—	Personal	—	Mr. Jones is a customer.
11. The X Y Supply Co.	Credit	Liability	—	Personal	—	This company supplies Mr. James with goods.
12. Bills Receivable	Debit	Asset	—	Personal	—	
13. Bills Payable	Credit	Liability	—	Personal	—	
14. Salaries and Wages	Debit	—	Expense	Impersonal	Nominal	
15. Rates and Taxes	Debit	—	Expense	Impersonal	Nominal	
16. Car Hire	Credit	—	Income	Impersonal	Nominal	
17. Furniture	Debit	Asset	—	Impersonal	Real	Furniture bought.
18. Telephone	Debit	—	Expense	Impersonal	Nominal	
19. Commissions Payable	Debit	—	Expense	Impersonal	Nominal	
20. Commissions Receivable	Credit	—	Income	Impersonal	Nominal	

3. All debit balances are either assets (if real or personal) or losses, i.e. expenses (if nominal).

4. All credit balances are either liabilities (if real or personal) or profits, i.e. income (if nominal).

In practice, the secretary will not bother very much with Rule 1 or Rule 2 given above. The only rules to which he need pay much regard are Nos. 3 and 4, and even then he need not memorize them. Throughout this book he will be asked to put the contents of Rules 3 and 4 to himself in the form of two questions. One question will arise when deciding how to treat a debit balance: "Is this an asset or a loss?" The other question arises, of course, when faced with a problem connected with a credit balance: "Is this a liability or a profit?"

One final point requires to be set out in this chapter. The reader has seen that there is only one indispensable book in book-keeping, and that is the Ledger. It follows, therefore, that the Ledger (even if split up into several parts for convenience) will contain, somewhere, the counterpart of every entry. The secretary who bears this fact in mind always will find many of his minor difficulties cleared away. If he encounters a balance or an account which puzzles him temporarily let him pause for a moment and ask himself: "What is the other aspect of this entry? I know that it must be somewhere in the Ledger." This is a practical point which, if adopted widely, would greatly minimize the trifling worries which sometimes beset the secretary. The reader is therefore asked to adopt it forthwith, and to apply it should he be puzzled by any entry or account he may encounter in the subsequent pages.

SELF-EXAMINATION QUESTIONS. I

1. Enumerate the systems of book-keeping in use in modern business.

2. What is the theory upon which Double Entry is based, and how is it put into practice?

3. How many essential and indispensable books of account are there?

4. Into what two main classifications do all Ledger Accounts fall?

5. What are assets and what are liabilities?

6. Which of the following accounts are personal and which impersonal?

Rates and Taxes Account.	Discounts Account.
J. Brown's Account.	The Town Gas Co., Ltd.
Wm. Brown's Account.	Kalamazoo, Ltd.
Carriage and Cartage Account.	Salaries Account.

7. Make out a draft of a Ledger ruling and explain the uses of the various columns.

8. Explain the meaning of the abbreviations "Dr." and "Cr."

9. To what type of account is the description "real" applied?

10. How is a credit note for £5 dealt with in the account of a customer who has purchased goods from a company for £50 and settles the account by a payment of £45?

CHAPTER II

SUBSIDIARY BOOKS OF ACCOUNT

It has been shown that every item in book-keeping is entered twice in the Ledger—one entry being a debit and the other a credit—the two entries together recording the two aspects which can be found in every commercial transaction. Now, if we examine the transactions of any business for a period of, say, one year we cannot fail to notice that one or other aspect of each transaction affects certain of the Ledger Accounts much more than others. For example, if a group of ten or twenty thousand sales transactions are examined it is seen at once that whilst these may represent debits to hundreds of personal accounts (the customers' accounts) the credit entry in every case is to Sales Account.

It is this fact which accounts for the use of subsidiary books to the Ledger. Whilst it would be possible to make a separate credit entry in Sales Account in respect of each sale and thus confine the whole of the book-keeping to one book, the work is cut down to a minimum, in practice, by the use of what is known as the "Sales Day Book" or "Sales Journal." This book collects together all the entries relating to the sales and, when totalled, permits the posting to the credit of Sales Account in the Ledger to be made in one monthly or other periodical figure.

Sales Day Book or Journal.

To understand the full use of the Sales Journal, it is first necessary to explain that the Sales Account in the Ledger may not give a trader all the information he requires. If it contained thousands of individual entries, for example, one under the other, it would be ~~difficult~~ not be easy

to tell the amount of the total sales at any moment. Neither would it be easy to tell the sales for a given month; nor could the trader distinguish between the sales of different types of goods.

The Sales Journal is devised to give either all or part of this information. Some traders are content if their Sales Journal gives the totals of each month's sales. Others insist that it shall give them all possible information as to the nature, type, quality and quantities, as well as the sale price, of each parcel of goods sold. But however much information is required, the design and working of every Sales Journal is extremely simple.

The Table on page 17 is a specimen ruling of a Sales Journal.

The " working " of this Journal is as follows—

1. Each sale is entered in date order.

2. Each sale to the customer is posted separately to the debit of his personal account in the Ledger.

3. For reference purposes the " folio " or page of each customer's account is entered in the " folio " column.

4. The corresponding credit (to complete the double entry) is made *in total* at the end of each month to " Sales Account " in the Ledger.

In the illustration on page 17 the credit to Sales Account would consist either of one entry only—under date 28th February, " By Sales for the month, £217," or the postings could distinguish between the types of sale. If the trader wishes to keep a separate record of his sales under the headings of the commodities in which he deals, he uses an analytical Sales Journal such as is illustrated. It will be seen that the sales have been analysed as between " Hardware " and " Enamelware." The totals of each column are then posted to the credit of the two Sales Accounts. In practice, of course, it is possible to make as many analyses as desired.

It will be noticed that a Ledger folio (No. 23) appears

SALES JOURNAL (OR DAY BOOK)

	Name	Ledger Folio	Total			Hardware			Enamelware		
193..			£	s.	d.	£	s.	d.	£	s.	d.
Feb. 1	W. Robins	10	40	–	–	40	–	–			
,, 2	J. Johnson	22	25	–	–				25	–	–
,, 3	W. Stubbs	49	10	–	–	10	–	–			
,, 4	F. Frost	56	20	–	–	20	–	–			
,, 5	Z. Kay	77	22	–	–	22	–	–			
,, 6	M. Moor	88	100	–	–				100	–	–
	And so on for the month.										
	TOTAL		£217	–	–	£92	–	–	£125	–	–
			(Ledger 23)			(Ledger 23)			(Ledger 24)		

underneath the total. This is the reference to Sales Account at folio 23, on which folio would be found a credit entry of £217. If, however, the sales are to be kept analysed, then separate Ledger Accounts are opened for " Hardware Sales (folio 23) " and " Enamelware Sales (folio 24)," and totals of £92 and £125 are posted to each account respectively. It should be noted that the total sales of £217 will not be posted in the Ledger if it is already posted in analysed sub-totals to " Hardware " and " Enamelware " Sales Accounts.

Purchase Journals.

Having explained the Sales Journal, our task in dealing with other subsidiary books is comparatively simple. The same principles apply to each one. They merely collect together entries of a like nature and, after classifying them, pass them to the debit or credit of the Ledger Account they affect. This being so, it is only necessary to make the following remarks on the uses of a Purchase Journal—

1. The Purchase Journal records all purchases of goods in chronological order.

2. The entries are made from the purchase invoices.

3. Each entry is posted to the credit of the suppliers' accounts in the Ledger.

4. The corresponding debit is made by posting the total purchases for the month to the debit of Purchases Account.

5. If it is desired to keep an analysis of different types of purchases, then additional columns are used just as in the case of the Sales Journal.

A specimen ruling of a Purchase Journal is given on page 19.

It will be seen that the ruling in this case is identical with that given for the Sales Journal, although in practice it is possible that additional columns—entailing further analysis—would be introduced.

PURCHASE JOURNAL

Date	Name	Ledger Folio	Total			Hardware			Enamelware		
			£	s.	d.	£	s.	d.	£	s.	d.
193.. Jan. 1	John Robinson	4	50	–	–	25	–	–	25	–	–
	And so on for the month.										

next edition –
Use more analysis
+ add the book

The total purchases for the month are posted to the debit of Purchases Account either in one figure or in two separate amounts, distinguishing between " Hardware " and " Enamelware " purchases.

Other Journals.

It will be clear to the reader at this stage that every Journal follows on the same principle as the two we have discussed. There is no limit to the number of Journals which may be introduced into an office. As each one performs exactly the same type of work, however, it will be appreciated that the reader need not memorize the rulings of each new Journal he encounters. During the course of his work as secretary it will doubtless be his duty to devise Journals for the condensation of details which would otherwise encumber his Ledger. From time to time the secretary may encounter Journals which, on account of their complicated rulings, appear difficult to understand. In such a case the difficulties will disappear if the following reasoning is pursued carefully—

1. This Journal has for its main object the collection of a number of items for posting to the debit or credit of a Ledger Account.

2. The corresponding entries are made either by individual postings to accounts or by a further posting in total.

3. Which column represents the receiving account? This gives the debit.

4. Which column represents the giving account? This gives the credit and completes the double entry.

5. Is this Journal devised to cover two or three sets of debit and two or three sets of credit postings? If so, which sets are complementary to the others?

The process of reasoning set out above will solve the working of Journal rulings which appear, at first sight, to be intricate and involved. If the answer to each step

is written down it will be found that the arrangement of even such a book, for example, as a Stockbrokers' Contango Journal is, in reality, very simple. Though apparently involved, such Journals contain, in fact, nothing but the fulfilment of double entry principles with the minimum of labour.

Common Types of Journal.

Although it is possible, as explained in the preceding paragraphs, to devise Journal rulings to suit any particular business, there are certain Journals which are more or less common to every concern. In addition to the Sales and Purchase Journals there are, for example—

Bills Payable Books—for the collection of the entries relating to bills into one total before posting to Bills Payable Account in the Ledger.

Bills Receivable Books—for similar functions in connection with the Bills Receivable.

There is no fixed ruling for either of these books, although stationers supply them in more or less standardized form. As long as they show clearly the name of the customer to be credited or of the supplier to be debited, any ruling suffices. It is usual to include columns to record the name of the drawer, acceptor, and drawee, and also the date upon which each bill falls due.

Then there is the "Expenses" Journal, which is frequently encountered, although some businesses manage to dispense with it altogether. This Journal serves to summarize the postings to "expenses" accounts, such as Stationery, Printing, Repairs, and Rates as distinct from "purchases" accounts relating solely to goods for resale. Businesses which dispense with an "Expenses" Journal merely credit the Cash Book with cheques drawn for the various payments to the suppliers, and debit the expenses accounts in the Ledger.

Ruling for Expenses Journal.

A simple ruling for an Expenses Journal is given on page 23.

As in the case of the other Journals we have considered—

1. Each item is posted individually to the credit of the suppliers' personal accounts in the Ledger.

2. The totals of the analysed columns are posted at monthly or other regular intervals to the debit of the expenses accounts in the Ledger, e.g. to Printing and Stationery Account, Carriage Account, and so on.

The Journal.

Lastly, there is "the" Journal, which is also illustrated on page 23.

This is the simplest type of Journal, and is used principally for transfers from one account in the Ledger to another whenever it is desired to keep a fuller record of the transfer than is possible in the Ledger itself.

Instances of entries in the Journal proper are afforded by the following—

(*a*) John Robinson's account, amounting to £52 4s. 8d., proves irrecoverable owing to his bankruptcy, and the amount has to be written off as a bad debt.

(*b*) A receipt of £102 8s. 9d. has been credited to the Ledger Account of Thomas Simms in error, instead of to the account of James Brown.

These two items would be journalized as shown on page 24.

As soon as the foregoing entries have been made in the Journal, they are posted to the Ledger. The first entry would be posted to the debit of Bad Debts Account, the second to the credit of John Robinson, the third to the debit of Thomas Simms, and the last to the credit of James Brown.

EXPENSES JOURNAL

Date	Supplier	Particulars	Folio	Total			Printing and Station-ery			Carriage			Repairs			Rent, Rates, Taxes, Sundries		
				£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.

JOURNAL

Date	Narrative	Folio	Dr.			Cr.		
			£	s.	d.	£	s.	d.

Journal

Date		Folio	Dr. £	Dr. s.	Dr. d.	Cr. £	Cr. s.	Cr. d.
	Bad Debts Account . . . . . *Dr.*		52	4	8			
	To John Robinson					52	4	8
	Being transfer of amount irrecoverable on bankruptcy of debtor.							
	Thomas Simms . . . . . *Dr.*		102	8	9			
	To James Brown					102	8	9
	Transfer of cheque from Mr. Brown posted to Mr. Simms' Account in error.							

SELF-EXAMINATION QUESTIONS. II

1. What is a subsidiary book and what are its uses?
2. Enumerate a few of the more common subsidiary books utilized in a modern office.
3. What are the uses of a Sales Journal and how is it ruled?
4. Draft a specimen ruling of a Purchase Journal.
5. How are the entries in an Expenses Journal treated?
6. In which subsidiary book would you enter a transfer of £42 3s. 9d. from the credit of A. Bard's account in the Ledger to the credit of A. Bardell's account? The original entry was made in error.
7. Enter the following transaction in the Journal (not in a Bills Receivable Journal)—

1930.
Jan. 1. T. Marshall handed to J. Johnson a Bill of Exchange for £300 8s. 2d. payable on 31st March, 1930.

8. Explain the following entry in the Bills Receivable Book set out below, and state how the double entry is effected—

BILLS RECEIVABLE BOOK

Number	Date	From Whom	Drawer	Acceptor	Where Payable	Date Payable	Term	Folio	Amount £	Amount s.	Amount d.	Remarks
48	1930 Jan. 1	T. Marshall	Self	T. Marshall	Midland Bank, Ltd.	1930 Apr. 4	3 mos.	S.L. 22	300	8	2	
									£300	8	2	

CHAPTER III

NOMINAL LEDGERS AND THE CASH BOOK

We have dealt so far with the Ledger and with the subsidiary Journals. We have seen that the Ledger is the only indispensable book in double entry book-keeping, but that Journals are employed for the classification and totalling of certain of the Ledger Accounts.

Subdivision of the Ledger.

We must now explain that the Ledger would be much too unwieldy in the majority of businesses if the whole of the accounts were kept in one bound volume. To overcome this difficulty the Ledger is broken up into several parts, each part being bound separately. The most important part which is so dealt with is the Ledger Account relating to Cash. This account—the Cash Account—is always bound up separately (although still forming part of the Ledger), and is known as the " Cash Book."

Private and Nominal Ledgers.

Another portion of the Ledger which is usually bound up separately is the section containing accounts of a private nature, such as the trader's Capital Account, Drawings Account, Profit and Loss Account, etc. These accounts in their separate binding are known collectively as the " Private Ledger."

In addition, many businesses separate their nominal accounts from the personal accounts and keep a " Nominal Ledger."

Sales and Purchase Ledgers.

Lastly, the personal accounts are divided as between purchasers' accounts and suppliers' accounts. The

former are bound together and are known as the " Sales Ledger," whilst the latter—also in their separate binding—are known as the " Purchase Ledger."

Other Divisions of the Ledger.

It must not be thought that the division of the Ledger outlined above is necessarily the division which is always adopted. Each business breaks up its books into the parts best suited to its requirements. Some businesses, for example, break up the Ledger into a Cash Received Book, a Cash Payments Book, a Private Cash Book, a Private Ledger, a Nominal Ledger, a Contract Ledger, a Sales Ledger, a Purchase Ledger, an Investment Ledger, and so on. Others, again, are known to conduct the whole of their business with one bound book only. Such businesses are, of course, very small undertakings indeed.

So long as it is borne in mind that all the various subdivisions merely make up the one Ledger, no difficulty can possibly arise. Each division of the Ledger is ruled in the same way as the Ledger and double entry is carried out just as though all the books were contained in the one binding. The Cash Book alone calls for detailed explanation.

Cash Books.

All Cash Books are, as explained above, really Cash Accounts. In these days it is usual to pay all receipts into a bank and to make all payments—save petty payments—by cheque. This being so, it follows that the Cash Book is, to all intents and purposes, the Bank Account. So much is this so that if the Cash Book were headed with the name of the bank, it could quite well be treated as the personal account of the bank concerned. To do so would undoubtedly clear away any possible doubts the student might have with regard to the entries he is called upon to make. In every case

the Bank Account (or Cash Book) has to be debited with any moneys paid into it, and credited with any cheques drawn upon it.

Multi-Column Cash Books.

Before the use of cheques became so common, it was quite customary for traders to refrain from paying all receipts into their bank. The cash so retained was used for the payment of a number of accounts, only the larger accounts being met by cheque. This practice forced the trader to distinguish in his Cash Book between the two types of payment, and he did this by using what was known as the "four column" Cash Book.

It may be stated that this old type of Cash Book is now practically non-existent, and the reader is not recommended to trouble about it beyond remembering its name. All receipts are now paid into the bank intact at once, and it is very unusual nowadays for large accounts to be paid by cash. This being so, the Cash Book now records the whole of the receipts and payments just as though it related to the Bank Account and to nothing else.

The Modern Cash Book.

The modern Cash Book in general use is ruled as shown on page 29.

The Inset Column. It will be seen that there are two columns devoted to the cash on the debit side. One of these two columns could be dispensed with, but it is usual to include it for the sake of convenience. It is useful because the various receipts for any particular day may be entered in the inside column, and then the total carried out in one figure to agree with the day's banking. Thus in the illustration given on page 29 the day's receipts, £60, are totalled in the inner column and carried out in one figure in the outer column. The

Dr. **CASH BOOK** *Cr.*

Date		Fol.	Discount						Date		Fol.	Discount					
			£	s.	d.	£	s.	d.				£	s.	d.	£	s.	d.
193..									193..								
	To Balance .	✓						100 – –									
Mar. 1	,, W. Allen .	10				20	– –		Feb. 1	By Furniture . .	9				20	– –	
,, 1	,, A. Bee . .	7	1	–	–	40	– –		Mar. 1	,, R. Robinson . .	4				30	– –	
								60 – –	,, 1	,, Wages . . .	6				10	– –	
									,, 5	,, M. Kain . .	5	3	–	–	75	– –	

JOURNAL

Date			*Dr.*			*Cr.*		
			£	s.	d.	£	s.	d.
193..								
Mar. 1	Discounts Allowed Account	*Dr.*	1	–	–			
	To A. Bee					1	–	–
,, 5	M. Kain	*Dr.*	3	–	–			
	To Discounts Received Account					3	–	–

same figure of £60 would appear as a single item in the Pass Book. There is no need for an " inset " column on the credit side, as each payment, representing a cheque, will be found entered separately in the Pass Book.

Discount. The next point to observe is the column on each side headed " Discount." These columns record cash discounts allowed (*Dr.*) to customers on receipt of their money, and cash discounts received (*Cr.*) from suppliers when settling their accounts.

The two columns are inserted for convenience only, as they do not actually form any integral part of the Ledger Account (Cash Account) with which we are dealing. In theory, the discounts would be passed through the ordinary Journal, as shown at the foot of page 29.

In practice, however, it is found convenient to keep the record of discounts allowed and received close to the cash entries to which they relate. To achieve this two columns of the *Journal* are introduced into the Cash Book, which then becomes—for this purpose only —a Journal.

The discounts allowed (*Dr.* side of Cash Book) are posted individually to the credit of the customers' accounts. Those received are posted to the debit of the suppliers' accounts. To complete the double entry the two discount columns are totalled at the end of the month and posted to the debit of " Discounts Allowed " Account, and to the credit of " Discounts Received " Account respectively.

The usual Cash Book now employed is, therefore, one having three columns on the debit side and two on the credit side, one column on each side being Journal columns and entirely unconnected with cash.

Special Cash Books.

Just as in the case of the Journals, it is possible to devise special Cash Books designed to meet the

particular needs of certain businesses. These Cash Books will be referred to from time to time in later chapters. In no case, however, will the principle underlying such special rulings differ from that governing the ordinary Cash Book dealt with above.

SELF-EXAMINATION QUESTIONS. III

1. Explain the method of dividing up the Ledger into sections separately bound.
2. In what respect is the Cash Book made to serve as a Journal, and how?
3. Draw up a specimen ruling of a Cash Book.
4. Enter the following items in your specimen Cash Book—

1930.
Jan. 1. Received £58 2s. 9d. from J. James.
,, 3. Paid £48 9s. 2d. to L. Thomas.
,, 4. Received £208 9s. 3d. from J. Jones in full settlement of his debt of £210 10s. The balance allowed as discount.
,, 10. Paid Wages, £100 8s.
,, 11. Rectified omission to enter balance at bank on 1st January of £502 6s. 4d.
,, 12. Paid Rates, £14 8s., and took a discount of £1 0s. 3d.

5. Tabulate the books which you are likely to find kept in the business of a builder and contractor.

CHAPTER IV

" SELF-BALANCING " LEDGERS

We have seen that it is found convenient to break up the Ledger into several subdivisions, for example into Cash Books, Sales Ledgers, Purchase Ledgers, etc. ~~It is now necessary to explain that, even after this subdivision, it is often essential to utilize more than one~~ bound book under each sub-heading. This is because the customers' accounts in, say, the Sales Ledgers are often so numerous that they require as many as twelve bound books to contain them. In such a case it is usual to give each book a distinctive name or number, i.e. " Sales Ledger A to K " or " Sales Ledger No. 1," and so on. It is this subdivision and employment of a great number of books that leads to the use of what is known as " Self-balancing " Ledgers.

The Meaning of " Self-Balancing."

It is perhaps unfortunate that we must commence by stating that the term " self-balancing " is misleading. No Ledger can balance itself. What the term is intended to imply is that the book-keeping is so arranged that the book-keeper can trace any errors he may have to the particular Ledger or Ledgers in which he has made the mistakes. In most textbooks the description of self-balancing methods is left over until a very late stage of the student's course. In the present instance, however, it has been thought more convenient to deal with it whilst still considering the Ledger. This procedure enables us to dispose of the impression, at this early stage, that self-balancing methods constitute a different system of book-keeping. The impression is entirely erroneous. The arrangement of Ledgers on a

self-balancing basis does not affect the double entry in any way, and the ordinary book-keeping proceeds exactly as before.

Double Entry Rules.

It is well known to the reader at this stage that the Ledger contains two entries in respect of every transaction. It records the " benefiting " of an account or person and the " giving " by an account or person, both of which aspects are to be found in every transaction. We know also that whilst both entries are to be found in the Ledger, it is possible that one aspect is contained in a " total " figure obtained through collecting like items in Journals. In addition, we know that if the Ledger has been broken up for purpose of convenience, it is likely that one aspect of certain entries will be contained in one bound Ledger and that the opposite aspect will be in another or other Ledgers.

Our study of the principles of double entry taught us that whether one transaction or a million transactions are entered in the Ledger, the totals posted to the debit of the accounts must always equal the credits. It follows that if several Ledgers are employed, the totals of the accounts in all the Ledgers must agree —i.e. the debits must equal the credits—though the debits in one particular bound section will not necessarily equal the credits in the same book.

An identical result is obtained if the debit and credit " balances " on all accounts are extracted and totalled. By " balance " is meant the net difference on an account containing debit and credit entries—this " difference " or " balance " being obtained by deducting the debits from the credits or vice versa. This extraction of Ledger totals or Ledger balances provides the check on the accuracy of the book-keeping to which we have already referred and, for that reason, it is carried out at regular intervals.

Trial Balance.

The extraction of Ledger balances is generally carried out on sheets of paper ruled with two columns, the debit balances being entered in one column and the credit balances in the other. When all the balances have been extracted the sheet is totalled. If the two totals of the columns add up to the same amount, then the Trial Balance is said to agree. If they differ, then one or perhaps more mistakes have been made in the book-keeping since the extraction of the last Trial Balance.

Tracing Errors.

In order to trace the mistakes revealed by a Trial Balance, it would normally be necessary to check a large part—and perhaps the whole—of the book-keeper's work. This, of course, would be a very lengthy procedure, and it is at this point that self-balancing methods come into play. Whenever self-balancing methods are employed, the book-keeper is able to tell at once the Ledger or Ledgers in which errors have been made. He is then able to minimize the work which would be entailed in a complete recheck of every Ledger.

Principles of the Method.

The principle upon which the self-balancing method is based is a very simple one. If the *total* debits and the *total* credits posted to each of several Ledgers could be ascertained and set against one another in Memoranda Accounts, then the balance on each Memorandum Account should agree with the balance shown by a detailed Trial Balance of each particular Ledger. If a discrepancy on any Memorandum Account arose, then it would be clear that a mistake had been made somewhere in the corresponding Ledger. The only problem,

therefore, is to find a way of ascertaining the totals of the entries which have been posted in detail to the various Ledgers. It is clear that the subsidiary books we have considered will not furnish the requisite information as they stand, for the Sales Journals entries may have been posted partly to each of twelve or more Sales Ledgers. To ascertain the exact totals of the entries debited to each Ledger from such books would entail lengthy analysis on sheets of paper. Obviously a procedure of this nature would entail so much work that it would outweight the advantages to be gained.

Analytical Journals.

The difficulty is overcome by ruling all subsidiary books in such a way as to analyse the entries under the headings of Ledgers as soon as they are made. In this way the total debits or credits to each Ledger are given at once in the form of totals at the foot of each column.

The various totals relating to each Ledger are then entered in the Memoranda Accounts referred to above. The same procedure is adopted with every subsidiary book so that each Memorandum Account, when completed, contains—in total amounts—all the cash debits, cash credits, Journal entries, and so on, which have been posted to the Ledger to which the Memorandum Account relates. The actual Ledger balances are extracted on sheets of paper, care being taken to distinguish between the balances relating to different Ledgers. The sheets are then totalled and compared with the Memoranda Accounts.

If one of the Ledger balance totals disagrees with the Memorandum Account, then that Ledger must be checked until the difference is located. Those Ledgers which agree with the Memoranda Account, however, need not be checked in any way.

Analytical Sales Journal.

The manner in which the total postings to different Ledgers is obtained may be illustrated by means of the Analytical Sales Journal, shown on the next page.

The reference to " Private Ledger 49 " in this illustration gives the folio in the Private Ledger to which the total sales for the month have been credited. The corresponding debits have, of course, been made by posting the individual items to the various Personal Accounts in the Sales Ledgers. The totals of the other four columns show the amounts which have been posted to each of the four Ledgers concerned. It is these totals which are entered in the Memoranda Accounts on folios 247, 248, 249, and 250 respectively of the Private Ledger.

Cash Analysis.

The analysis of the cash posted to different Ledgers is, of course, equivalent to the analysis of transfers from and to the Cash Ledger. It is possible, however, to rule the Cash Book so as to give the totals of the cash postings to each Ledger. Most rulings for such a Cash Book also provide for the appropriate analysis of the discounts received and allowed. An illustration is given on page 38.

Other Journals.

It is not necessary to give illustrations of the other subsidiary books, for the reader will have appreciated by now the principles upon which the analysis is made. There is no hard and fast ruling for any book; so long as the secretary is able to ascertain the totals of the postings to each of his Ledgers, he may adopt any ruling which is convenient to him.

Sales Ledger Adjustment Accounts.

We will now deal more fully with the Memorandum Account, to which we have frequently referred. This

SALES JOURNAL

Date	Particulars	Folio	Total			Ledger 1			Ledger 2			Ledger 3			Foreign Ledger		
			£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.
193..																	
Dec. 1	J. Ameson	29	202	8	3				202	8	3						
,, 2	Z. Matthewson & Co.	44	189	12	7	189	12	7									
,, 4	J. Curtain & Son	62	542	17	8							542	17	8			
,, 6	F. Atkins	111	52	9	4										52	9	4
,, 7	M. Wilkes	73	177	2	2							177	2	2			
,, 9	L. Adams	21	248	19	9	248	19	9									
,, 10	M. Arnott	47	290	16	3				290	16	3						
,, 13	L. Townrow & Co.	189	149	6	7							149	6	7			
,, 17	Y. Farmer & Sons	200	788	18	2	788	18	2									
,, 20	M. Martin & Sons	145	52	2	8										52	2	8
,, 21	W. Waterer & Sons, Ltd.	88	200	1	4										200	1	4
,, 23	B. Bates & Co., Ltd.	87	190	2	3				190	2	3						
,, 25	M. Watkins	72	77	2	4										77	2	4
,, 28	W. Wallsher	51	104	1	1	104	1	1									
,, 29	A. Abbott	62	202	9	8				202	9	8						
,, 30	A. Anderson	73	109	4	2	109	4	2									
,, 31	B. Briggs	187	108	2	7				108	2	7						
			£3,685	16	10	£1,440	15	9	£993	19	–	£869	6	5	£381	15	8
			Private Ledger Folio 49			Private Ledger Folio 247			Private Ledger Folio 248			Private Ledger Folio 249			Private Ledger Folio 250		

CASH BOOK

(Receipts Side Only)

Date	Details	Fol.	Sales Ledger No. 1						Sales Ledger No. 2						Sales Ledger No. 3						Sales Ledger Foreign						Other Ledgers			Bank		
			Dis.			Cash			Dis.			Cash			Dis.			Cash			Dis.			Cash								
			£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.

CASH BOOK

(Payments Side Only)

Date	Details	Fol.	Purchase Ledger A–K						Purchase Ledger L–Z						Private Ledger						Bank					
			Dis.			Cash			Dis.			Cash			Dis.			Cash								
			£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.	£	s.	d.

account does not form any part of the double entry book-keeping, and an entry in it must not be regarded as a posting. As already explained, there is one Memorandum Account for each Ledger, and each one is known as an "Adjustment Account," e.g. " Sales Ledger No. 1 Adjustment Account," " Purchase Ledger Adjustment Account," and so on. To facilitate easy reference, they are usually kept in the last few pages of the Private Ledger. We set out on the next page an illustration of an Adjustment Account, and on page 42 a Trial Balance taken from the books to which the Adjustment Account, in part, relates.

Note. For illustration purposes the Trial Balance records totals only; the detailed lists of balances comprising each total would, in practice, be annexed to this summarized Trial Balance.

Tracing Differences.

As soon as the lists of balances have been extracted by the book-keepers, they are handed to the secretary, who proceeds to compare them with the Trial Balance. The comparison appears somewhat as follows—

	Balances per Adjustment Account	Balances per Lists extracted from Ledgers	Errors to be Traced
	£ s. d.	£ s. d.	£ s. d.
Sales Ledger—			
No. 1 . .	42,896 18 8	42,896 18 8	Nil
No. 2 . .	36,282 4 7	36,282 4 7	Nil
No. 3 . .	26,284 9 2	26,284 11 –	1 10
Foreign . .	18,628 8 4	18,628 8 4	Nil
And so on.			

It will be observed that the Adjustment Account, which we have chosen for an illustration, shows a balance on No. 3 Ledger less than the total given in the Trial Balance by 1s. 10d. It is now the duty of

SALES LEDGER NO. 3 ADJUSTMENT ACCOUNT

Folio 249

Dr. *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Dec. 1	To Opening Balance b/d		25,925	3	6	Dec. 31	By Cash received during the Month	C.B. 29	428	6	9
,, 31	,, Sales for the Month	S.J. 22	869	6	5	,, 31	,, Discounts allowed during the Month	C.B. 29	21	2	9
,, 31	,, Transfers from other Ledgers	T.J. 9	80	9	2	,, 31	,, Returns and Allowances	S.J. 192	20	6	–
						,, 31	,, Acceptances of Customers —Bills of Exchange	B.B. 100	100	9	9
						,, 31	,, Transfers to other Ledgers	T.J. 9	20	4	8
						,, 31	,, Balance at End of month c/d		26,284	9	2
		£	26,874	19	1			£	26,874	19	1
193.. Jan. 1	To Balance b/d		26,284	9	2						

TRIAL BALANCE AS AT 31st DECEMBER, 193..

		£	s.	d.	£	s.	d.
SALES LEDGERS—							
Balances on No. 1 Ledger	(493 Accounts)	42,896	18	8			
Balances on No. 2 Ledger	(480 Accounts)	36,282	4	7			
Balances on No. 3 Ledger	(397 Accounts)	26,284	11	–			
Balances on Foreign Ledger	(149 Accounts)	18,628	8	4			
PURCHASE LEDGER—							
Balances on Ledger A–K	(159 Accounts)				26,289	4	3
Balances on Ledger L–Z	(179 Accounts)				32,275	7	2
OTHER LEDGERS—							
Private Ledger					49,864	9	3
Nominal Ledger					6,229	8	1
Cash Book					9,433	12	–
		£124,092	2	7	£124,092	–	9

the book-keeper to turn to the lists of balances attached to the summarized Trial Balance. He need only concern himself with those relating to Sales Ledger No. 3. These contain the error of 1s. 10d. and must be checked over thoroughly. If there has been no mistake in the extraction of the balances, then it is necessary to call over all the postings which have been made in Ledger No. 3 from the various subsidiary books until the mistake has been found. As a result of the self-balancing system, however, the checking work is confined to Ledger No. 3, all the other Ledgers being " in agreement " with their respective Adjustment Accounts.

Contra Adjustment Accounts.

As mentioned earlier in the chapter, the Adjustment Accounts are usually kept in the last few pages of the Private Ledger. This has two advantages. It enables the secretary to complete the compilation of a Trial Balance without waiting for the extraction of the individual balances from the various Ledgers; he uses the balances shown on the various Adjustment Accounts.

The other advantage is that the secretary may, if he so desires, keep the Adjustment Accounts secret from his subordinate staff. In such a case he waits for the book-keepers to produce their lists of balances. The book-keepers who produce correct lists are notified accordingly; the others are told that their lists contain errors whereupon they proceed to check over their work since the last balancing date.

In spite of the advantages of this method some secretaries find it desirable to permit the book-keeper or book-keepers to keep *contra* Adjustment Accounts themselves in the back of their respective Ledgers. The name given to these *contra* accounts is " Private Ledger Adjustment Account " or " General (or Nominal) Ledger Adjustment Account." The items posted to

them are identical with those posted in the Adjustment Accounts kept in the Private or General Ledger, but the sides are reversed—debits being posted as credits and vice versa.

The effect of this procedure is that each book-keeper has a replica of the Adjustment Account proper, and can regard his Ledger as completely self-contained.

Transfers and Contra Accounts.

One final point remains to be explained before concluding the chapter. It will be found, in practice, that although the majority of entries in the Ledgers have been posted from analysed subsidiary books, a few entries will represent transfers from one Ledger to another. It is obvious that each transfer must be recorded in the Adjustment Accounts of the two Ledgers affected. In order to bring this about, it is usual to pass all *contra* items or inter-Ledger transfers through a Transfer Journal. This book is ruled in such a way as to give a debit and a credit column for each Ledger. Each transfer is then recorded fully in a "Details" Column. The Ledger which contains the account to which the transfer has been debited, receives a debit in the Transfer Journal. On the other hand, of course, the other Ledger receives the corresponding credit. The totals of all the columns are entered in the Adjustment Accounts in the usual way.

A specimen ruling of a Transfer Journal is given on page 45.

Notes. The total at the foot of each column shows the amount transferred to or from a Ledger during the month. These totals are entered in each of the Adjustment Accounts as explained above. The illustration includes the names of six of the Ledgers, but it must be understood that every Ledger, except the Cash Ledger (or Cash Book) must be provided for.

TRANSFER JOURNAL

Date	Details	Fol.	Fol.	Sales Ledger No. 1		Sales Ledger No. 2		Sales Ledger No. 3		Sales Ledger Foreign		Purchase Ledger A–K		Purchase Ledger L–Z	
				Dr.	*Cr.*	*Dr.*	*Cr.*	*Dr.*	*Cr.*	*Dr.*	*Cr.*	*Dr.*	*Cr.*	*Dr.*	*Cr.*
				£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.

SELF-EXAMINATION QUESTIONS. IV

1. Write a short précis of the self-balancing system and enumerate its advantages.

2. What is the use of a Transfer Journal in a self-balancing system?

3. Give a specimen ruling for a Sales Journal in a business in which four Ledgers are kept.

4. What is a Purchase Ledger Adjustment Account and where is it kept?

5. The undermentioned particulars have been extracted from the books of Messrs. James Ogden & Co., who keep only one Sales Ledger. You are required to prepare the relative "Sales Ledger" and "General Ledger" Adjustment Accounts as on 31st December—

		£	s.	d.
June 30.	Debtors' Balances	28,394	12	6
Dec. 31.	Transactions for the half-year to date—			
	Sales to Debtors	58,421	10	8
	Returns from Debtors	691	12	–
	Cash received from Debtors	41,344	8	6
	Discounts allowed to Debtors	1,504	9	3
	Acceptances received from Debtors	4,210	1	2
	Acceptances returned dishonoured	550	–	–
	Bad Debts written off	942	10	–
	Sundry Charges debited to Debtors	29	4	6

—(*Chartered Accountants.*)

CHAPTER V

PROFIT AND LOSS ACCOUNT AND BALANCE SHEET

As book-keeping records every commercial transaction into which a trader or a partnership or a limited company enters for the purpose of making profit, it follows that the profit or loss which has been made can be ascertained from the books. It is this matter which falls to be dealt with at this point.

The Record of Transactions.

It does not require any knowledge of book-keeping to say which accounts in the Ledger should be examined for the purpose of ascertaining the profit or loss. Take, for example, the case of a trader in business as a corn merchant. His profit or loss for any given period must be represented by the difference between his purchases and his sales of corn, less the rent he pays for his premises, wages and salaries, rates, insurance, and other outgoings. This is only common-sense reasoning, and is followed even by traders who attempt to trade without keeping books, and who are able to arrive at their profit only by means of their Bank Pass Books.

With a full record of all income and all expenditure in the books the procedure becomes a simple one. The preparation of a Profit and Loss Account follows the same course as that dictated by the common-sense reasoning referred to above. It requires no memorizing of rules. The reader has only to remember that he must set off the income against the expenditure in order to arrive at the profit made or the loss sustained. If he endeavours to memorize set definitions of profit and loss items and Balance Sheet items, without understanding the distinction, then he is certain to commit errors of principle.

X Y Z CO., LTD.—TRIAL BALANCE—31st DECEMBER, 193..

Folio		Dr.			Cr.		
		£	s.	d.	£	s.	d.
2	Purchases (for the year)	22,040	9	8			
5	Sales (for the year)				33,878	2	3
7	Rent	1,092	5	7			
8	Rates	500	1	2			
14	Wages	5,129	10	8			
15	Salaries	1,095	14	8			
18	Discounts Allowed	988	3	5			
22	Discounts Received				592	8	6
31	Insurance	100	2	1			
35	Postages and Telegrams	148	19	2			
42	Advertising	88	6	6			
50	General Expenses	29	8	8			
61	Share Capital (at beginning and end of year)				5,000		–
77	Sales Ledger Adjustment Account (Debtors on Sales Ledger)	15,293	7	5			
82	Purchase Ledger Adjustment Account (Creditors on Purchase Ledger)				9,828	6	7
C.B. 45	Cash at Bankers	2,792	8	4			
		£49,298	17	4	£49,298	17	4

The Trial Balance.

The first step taken in the ascertainment of profit is the extraction of a Trial Balance from the Ledger (or Ledgers, if the book has been subdivided). We give on page 48 a specimen of a Trial Balance taken from the books of the X Y Z Co., Ltd., after the company has been trading for a year.

Trading and Profit and Loss Account.

A brief glance at the foregoing Trial Balance shows that the first twelve items relate to the year's trading and must, if set off against each other, reveal the profit for that period. It is only necessary, therefore, to set these twelve items down, the expense items on one side and the income items on the other, and this is done as shown on page 50.

The account now shows that the X Y Z Co., Ltd., has made a net profit of £3,257 9s. 2d. for the year. As the directors are also desirous of knowing the amount of the gross trading profit (i.e. before charging the administrative charges), a break has been made in the account. The break enables the secretary to report that a gross profit of £6,708 1s. 11d. was realized on sales amounting to £33,878 2s. 3d.

Stock-in-Trade.

In the illustration given above the whole of the goods bought (at a cost of £22,040 9s. 8d.) were sold during the year ended 31st December (for £33,878 2s. 3d.). It is, however, very unusual for the whole of a company's purchases to be so disposed of during any one year. In practically every case there remains a certain quantity of goods in the warehouse or the factory. It is obvious that this "Stock-in-trade," as it is called, must be valued and brought into account, for if the X Y Z Co., whose account is given on page 50, found

X Y Z CO., LTD.

TRADING AND PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31st DECEMBER, 193..

Dr. *Cr.*

	£	s.	d.		£	s.	d.
To Purchases	22,040	9	8	By Sales	33,878	2	3
,, Wages	5,129	10	8				
,, Gross Profit c/d	6,708	1	11				
	£33,878	2	3		£33,878	2	3
To Salaries	1,095	14	8	By Gross Profit b/d	6,708	1	11
,, Rent	1,092	5	7	,, Discounts Received	592	8	6
,, Rates	500	1	2				
,, Discounts Allowed	988	3	5				
,, Insurance	100	2	1				
,, Postages and Telegrams	148	19	2				
,, Advertising	88	6	6				
,, General Expenses	29	8	8				
,, Net Profit for the year	3,257	9	2				
	£7,300	10	5		£7,300	10	5

that stock to the value of £100 had been overlooked, it would be that much better off, and the net profit would be £3,357 9s. 2d. instead of £3,257 9s. 2d. Stock-in-trade, therefore, is always valued and brought into account. The Secretary is recommended to record it by entering it in the Trial Balance before the Profit and Loss Account is compiled. As with every other item in book-keeping, it must be entered in the Trial Balance twice—once as a debit, representing an asset, and once as a credit, representing gain or profit to be added to the sales in the Profit and Loss Account.

Payments in Advance and Reserves.

It may happen that the debits appearing in a Trial Balance, in respect of expenses, represent more than the appropriate charge for the period under review. It is possible, for example, that the rates paid (and appearing as a debit of £500 1s. 2d. in the above Trial Balance) represent the rates for eighteen months, six months' charge having been paid in advance. In such a case the appropriate proportion has to be carried forward, and this is done by reducing the charge to Profit and Loss Account and carrying forward the amount paid in advance as a debit balance.

On the other hand, of course, the debits appearing in a Trial Balance may not represent a full year's charge. This might arise if a supplier, for example, had omitted to render his invoice for goods he had supplied. In such a case the company must make a reserve by increasing the debit for purchases by an appropriate amount and by carrying forward a similar amount, among the creditors, to represent the liability. It will be observed that both in the case of payments in advance and in the case of reserves for accrued expenses, it is essential that double entry be carried out. The necessary entries are, therefore, made in the appropriate Ledger Accounts as usual.

Reserves in the Ledger.

There is some difference of opinion as to the method of recording reserves and payments in advance in the Ledger. Sometimes they are entered in a "Debtors and Creditors Account," being transferred to their individual accounts when the books have been closed for the year. The simpler plan is to carry reserves down in each of the Ledger Accounts concerned. This latter method is illustrated on pages 53 and 54, and as it is simpler the student is advised to adopt it.

The Meaning of a Balance Sheet.

A brief reference was made at the commencement of this chapter to the reasoning which a trader follows when calculating his approximate yearly profit when no books have been kept. He sets down his revenue and expenditure for the year as accurately as he can recall. Then, after including any stock remaining in his warehouse, he deducts his outgoings from his incomings, treating the difference as profit or loss for the year. Now such a trader would naturally apply some sort of test to this estimate of profit. He would ask himself whether his net assets disclosed an increase over the amount he possessed a year ago, equal to the profit he believes he has made. He proceeds to satisfy himself as follows. He first finds that his estimated profit amounted to £1,250, out of which he has withdrawn £250 for living expenses. He knows that his sole asset a year previously consisted of £5,000 cash. He next lists the net assets he now possesses and finds that they consist of £2,000 in Cash, £2,000 in Stock, and £3,000 in Debtors, and that his liabilities amount to £1,000. These figures give a net amount of assets of £6,000, i.e. £1,000 more than was possessed by the trader a year previously. The result confirms the estimate made by the trader. It shows that he has made

Illustration of the Inclusion of a Reserve

Dr. **HEATING AND LIGHTING ACCOUNT** *Cr.*

1930			£	s.	d.	1930			£	s.	d.
Jan. 18	To Cash paid for Heating and Lighting for half-year to 31st December last	C.B. 49	42	14	8	Jan. 1	By Reserve brought forward (estimated amount outstanding at close of previous year)	√	42	–	–
July 3	,, Cash paid for Heating and Lighting for half-year to 30th June, 1930	C.B. 92	36	8	4	Dec. 31	,, Transfer to Profit and Loss Account (representing charge for the year 1930)	J. 86	77	3	–
Dec. 31	,, Reserve for estimated amount outstanding at this date	c/d	40	–	–						
			£119	3	–				£119	3	–
						1931 Jan. 1	By Reserve brought forward	b/d	40	–	–

Illustration of the Calculation of a Payment in Advance

Dr. **RATES ACCOUNT** *Cr.*

1930			£	s.	d.	1930			£	s.	d.
Jan. 1	To Amount paid in advance (brought forward from previous year's account)	b/d	172	1	8	Dec. 31	By Amount paid in advance to 31st March, 1931, carried forward to next year	c/d	172	1	8
Mar. 31	,, Cash paid for Rates for half-year to 30th September	C.B. 40	344	3	4	,, 31	,, Transfer to Profit and Loss Account for the year 1930	J.20	688	6	8
Sep. 30	,, Cash paid for Rates for half-year to 31st March	50	344	3	4						
			£860	8	4				£860	8	4
1931											
Jan. 1	To Amount paid in advance brought forward	b/d	172	1	8						

£1,000 net profit, in addition to the sums he has withdrawn for living expenditure, i.e. a total of £1,250.

It must be remembered that the foregoing is merely an illustration of the elementary procedure followed by traders who have not the advantage of arriving at their profits correctly and expeditiously from a proper set of books. The principle which underlies this crude method of taking stock of the position is precisely the same as that which underlies the preparation of a proper Balance Sheet. The Balance Sheet sets out the assets and liabilities of a business as they exist at any given date, and shows the capital or net value of the business. Every asset and liability included in the Balance Sheet, however, is recorded in the Ledger, and it is therefore unnecessary to resort to guesswork. The Trial Balance furnishes us with all the material we require.

Assets and Liabilities in Trial Balance.

We may now test the accuracy of this statement by turning back to the Trial Balance of the X Y Z Co., Ltd. It will be found that the only items left over after the preparation of the Profit and Loss Account are: Share Capital, Debtors, Creditors, and Cash at Bankers. These, as we have already learnt, are either assets or liabilities. They represent debts or property owned by the company, or liabilities of the company as at 31st December. Let us set them, therefore, one against the other—

31st DECEMBER, 193..

Liabilities	£	s.	d.	Assets	£	s.	d.
Creditors . .	9,828	6	7	Debtors . .	15,293	7	5
Capital at beginning of year .	5,000	–	–	Cash at Bankers	2,792	8	4
	14,828	6	7				
Excess of Assets over Liabilities	3,257	9	2				
	£18,085	15	9		£18,085	15	9

We now see that as the result of the year's trading the net assets have increased by £3,257 9s. 2d. If we refer to the Profit and Loss Account we find confirmation of this figure, for it equals the amount of profit which that account tells us has been earned. Finally, we observe that the capital of the X Y Z Co., Ltd., which a year ago stood at £5,000, now amounts to £8,257 9s. 2d. This simple illustration demonstrates that double entry book-keeping permits us—

1. To arrive, with certainty, at the profit earned by a business.

2. To produce a Balance Sheet which will show the position of that business at a given date and, being complementary to it, will furnish a proof of the accuracy of the Profit and Loss Account.

Form of the Balance Sheet.

In accordance with our practice, we have dealt only with the underlying principles of a Balance Sheet in very simple language. Having mastered the essential points, we must now consider the details of their practical application which, if treated earlier, might have obscured the whole chapter.

It must not be thought that the haphazard listing of assets and liabilities shown above constitutes a Balance Sheet. On the contrary, this most important document is compiled in accordance with certain well defined rules.

In the case of a sole trader's business it is customary to set the items out in the following order—

ASSETS. According to their realizability, e.g.—

Cash.
Bills Receivable.
Debtors.
Stock.
Furniture.
Plant.

LIABILITIES. According to the order in which they are payable, e.g.—

Secured Creditors.
Bills Payable.
Open Accounts (Creditors).
Proprietor's Capital.

A somewhat similar order is adopted in the case of partnerships, the only important difference being that partners' advances to the firm constitute a prior claim on the business to the Capital Accounts of the partners. They are, therefore, shown immediately after the creditors. This matter will be dealt with more fully in the later chapter on " Partnership Accounts."

In the case of limited companies, with which we are principally concerned, the reverse order is adopted, the assets appearing in the order of their permanency and the Capital Account always figuring as the first liability.

The Capital Account.

It is generally a matter of some difficulty for the student to understand readily the Capital Account. Especially does he find it hard to grasp that it is a liability. He asks, not without reason, how it is possible for a trader to have a liability—the Capital Account—to himself. The difficulty disappears, however, if it can be grasped that the business must be treated impersonally. It must be regarded as a separate and distinct entity from its proprietor or proprietors. This done, it is easy to appreciate that the business is indebted to its proprietor for the net excess of the assets over the liabilities. This indebtedness constitutes the Capital Account.

Partners' Capital Accounts.

Whenever the business is owned by partners, as distinct from a sole trader, the Private Ledger (and

every Balance Sheet which is prepared) records the Capital Account of each partner separately. The total capital will still be no greater than the net excess of assets over liabilities, but it is apportioned in accordance with the amounts due to each partner, following the terms and provisions of the partnership deed.

Limited Companies' Capital.

The reader will be familiar with the law relating to the capital of limited companies from his legal studies. He will recall that the Nominal or the Issued Capital of a company may consist of shares having all the same rights, or it may consist partly of shares having a preference as to capital and/or dividend. Again, it may be made up partly of shares carrying deferred or ordinary rights. The capital of these companies is always shown in the Balance Sheet in such a way as to distinguish between the types of share; apart from this there is no difference between the Capital Account of a sole trader, the Capital Accounts in a partnership, and the issued capital of a limited company.

"Pro Forma" Balance Sheet.

We may now examine an actual *pro forma* Balance Sheet, of a business belonging to a sole trader, Mr. Joseph Robinson. The Trial Balance is presented to us originally with a footnote to the effect that the closing Stock-in-trade amounts to £50,292 6s. 6d. In addition, we are told that the rent paid in advance amounts to £490 2s. 3d., and that there is a liability which has not yet been passed through the books in respect of salaries accrued due, amounting to £84 10s. Our work will be facilitated if we first group the various items in the Trial Balance in such a way as to distinguish between revenue charges and assets and liabilities. It is then a good plan to

JOSEPH ROBINSON

TRIAL BALANCE—30th JUNE, 193..

		Dr.			Cr.		
EXPENSES AND INCOME—		£	s.	d.	£	s.	d.
Purchases Account		190,462	16	8			
Stock (at commencement of year)		64,892	9	9			
Sales					316,736	16	11
Wages—Warehouse		14,902	8	8			
Freight and Carriage		2,908	6	3			
Rent of Cellars, etc.		1,960	9	–			
Salaries		2,392	6	8			
Printing and Stationery		598	2	3			
Telegrams and Telephone		488	10	8			
Advertising		1,003	4	8			
Discounts Allowed		2,190	3	7			
Discounts Received					1,002	4	4
Bad Debts		250	5	11			
Lighting and Heating		303	8	4			
Travellers' Commission		2,304	4	5			
Travelling Expenses		1,290	2	3			
Salaries Accrued Due	*	84	10	–			
Rent Paid in Advance	*				490	2	3
Stock-in-trade (at end of year)	*				50,292	6	6
LIABILITIES AND ASSETS—							
Salaries Accrued Due	*				84	10	–
Rent Paid in Advance	*	490	2	3			
Stock-in-trade (at end of year)	*	50,292	6	6			
Freehold Premises		80,000	–	–			
Cash at Bank		35,298	3	6			
Bills Receivable		7,700	14	3			
Sundry Creditors					20,204	9	8
Bills Payable					9,795	10	4
Sundry Debtors		7,001	2	3			
Joseph Robinson—Capital Account (at beginning of year)					72,500	–	–
Joseph Robinson—Drawings Account		4,292	2	2			
		£471,106	–	–	£471,106	–	–

incorporate the three adjustments in the Trial Balance itself, remembering that the double aspect of each must be recorded. For reference purposes we will distinguish these adjustments by means of asterisks. This done our Trial Balance appears as shown on page 59.

The preparation of the Profit and Loss Account and the Balance Sheet from the above Trial Balance is an extremely simple task, and consists of little more than the regrouping of the various items. The salaries accrued due are added to the salaries paid, in order to avoid two entries under the same heading in the accounts. Similarly, the rent paid in advance is deducted from the rent paid. The result is given on pp. 61 and 62.

The Balance Sheet, which appears on page 62 will now be used to demonstrate that the capital of partners in a partnership, or the issued capital of a limited company, correspond to the Capital Account of a sole trader in their respective Balance Sheets.

Partnership Balance Sheet.

We will first assume that the business whose Balance Sheet is given, is carried on by a partnership consisting of two partners. These partners—Joseph Robinson and James Stanton—are equal partners and their Capital Accounts amount to £36,250 each. During the year under review Joseph Robinson has drawn £2,000 and James Stanton has drawn £2,292 2s. 2d. The Profit and Loss Account for this partnership is made out in exactly the same form as that for the sole trader, but the balance of profit is carried to what is known as an "Appropriation Account." This is an account which is utilized for the appropriation or division of profits among partners or for the charging of any expenses which cannot be looked upon as normal trading outgoings. It is not generally regarded as necessary in the case of a sole trader, as no division or sharing of profit takes place.

JOSEPH ROBINSON

TRADING AND PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30th JUNE, 193..

Dr.	£	s.	d.		£	s.	d.	*Cr.*
To Stock at commencement of year	64,892	9	9	By Sales	316,736	16	11	
,, Purchases	190,462	10	8	,, Stock at end of year	50,292	6	6	
,, Warehouse Wages	14,902	8	8					
,, Freight and Carriage	2,908	6	3					
,, Gross Profit c/d	93,863	2	1					
	£367,029	3	5		£367,029	3	5	
To Salaries	2,476	16	8	By Gross Profit b/d	93,863	2	1	
,, Rent of Cellars, etc.	1,470	6	9	,, Discounts Received	1,002	4	4	
,, Printing and Stationery	598	2	3					
,, Telegrams and Telephone	488	10	8					
,, Advertising	1,003	4	8					
,, Discounts Allowed	2,190	3	7					
,, Bad Debts	250	5	11					
,, Lighting and Heating	303	8	4					
,, Travellers' Commissions	2,304	4	5					
,, Travelling Expenses	1,290	2	3					
,, Net Profit carried to Balance Sheet	82,490	0	11					
	£94,865	6	5		£94,865	6	5	

JOSEPH ROBINSON

BALANCE SHEET AS AT 30th JUNE, 193..

Liabilities		£	s.	d.	Assets	£	s.	d.
Bills Payable		20,204	9	8	Cash at Bank	35,298	3	6
Sundry Creditors		9,795	10	4	Bills Receivable	7,700	14	3
Amounts Accrued Due		84	10	–	Sundry Debtors	7,001	2	3
Joseph Robinson—					Payments in Advance	490	2	3
Capital Account as at 1st July, 193..	£72,500 –				Stock-in-Trade	50,292	6	6
Add Profit per Profit and Loss Account	82,490 · 11				Freehold Premises	80,000		–
	154,990 · 11							
Less Drawings for year	4,292 2 2							
		150,697	18	9				
		£180,782	8	9		£180,782	8	9

The following illustrates the sharing of profit between Robinson and Stanton—

APPROPRIATION ACCOUNT

	£	s.	d.		£	s.	d.
To Transfer to Partners' Current Accounts—				By Net Profit per Profit and Loss Account . .	82,490	–	11
Joseph Robinson . .	41,245	–	6				
James Stanton . .	41,245	–	5				
£	82,490	–	11	£	82,490	–	11

The Balance Sheet of Robinson and Stanton's business does not differ from that which we have already made out for the sole trader, except as regards the Capital Account. In the case of the partnership Balance Sheet, we make the substitution which is indicated by the comparative tabulation given on page 64.

Partners' Current Accounts.

It will be observed from the tabulation that whereas the profit for the year is added to the sole trader's Capital Account, it is kept distinct in the case of the partnership. This is the usual practice although, if desired, the partners' Capital and Current Accounts may be merged. It is more usual to adhere to the "fixed capital" method if fixed capitals are stipulated in the partnership deed, or if interest is allowed on partners' Capital Accounts before dividing the profits.

A Company's Balance Sheet.

We may now apply a further variation to the illustration by assuming that the business is owned by Joseph Robinson, Ltd. This is a company having an authorized capital of £75,000 divided into 60,000 Preference Shares of £1 each and 15,000 Ordinary Shares of £1 each. Of this the whole of the Preference Capital and £12,500 of the Ordinary Capital has been issued and is fully paid.

Apart from a slight re-arrangement of the order of

EXTRACT FROM SOLE TRADER'S BALANCE SHEET

Liabilities	£	s.	d.
Mr. Joseph Robinson—			
Capital Account as at 1st July, 193..	72,500	-	
Add Profit for the year per Profit and Loss Account	82,490	-	11
	154,990	-	11
Less Drawings during the year	4,292	2	2
	£150,697	18	9

EXTRACT FROM PARTNERSHIP BALANCE SHEET

Liabilities	£	s.	d.
Partners' Capital Accounts—as at 1st July, 193..—			
Mr. Joseph Robinson	36,250	-	-
Mr. James Stanton	36,250	-	-
	72,500	-	-
Partners' Current Accounts			
Mr. Joseph Robinson—			
Share of Profit for the year £41,245 - 0			
Less Drawings 2,000			
	39,245	-	0
Mr. James Stanton—			
Share of Profit for the year £41,245 - 5			
Less Drawings 2,292 2 2			
	38,952	18	3
	£150,697	18	9

the assets and liabilities, the only alteration which takes place in the Balance Sheet concerns the Capital Account. Just as in the case of the partnership, the Profit and Loss Account is unaffected. In the Balance Sheet we insert the following under the liabilities in the place of Mr. Joseph Robinson's Capital—

LIABILITIES

	£	s.	d.	£	s.	d.
AUTHORIZED CAPITAL—						
60,000 Preference Shares of £1 each	60,000	–	–			
15,000 Ordinary Shares of £1 each	15,000	–	–			
	£75,000	–	–			
ISSUED CAPITAL—						
60,000 Preference Shares of £1 each fully paid	60,000	–	–			
12,500 Ordinary Shares of £1 each fully paid	12,500	–	–			
				72,500	–	–
Profit and Loss Account—profit for the year per annexed account .				80,490	–	11
				£152,990	–	11

It should be noted that the item " Drawings " does not appear in the Balance Sheet of a company. Shareholders, unlike sole traders or partners, cannot draw moneys from the company in anticipation of profit except by way of dividends properly declared.

Conclusion.

We conclude this chapter by explaining the reason for adapting one Trial Balance to illustrate the accounts of three different concerns. If the reader has understood thoroughly the different methods of showing the capital of a sole trader, a partnership, and of a company, then he will have little difficulty in his study of the subsequent chapters. He will find that except as regards the capital and the method of dealing with the profit,

there is no difference between Company Accounts and those of any other concern. It is true that the order in which assets and liabilities are shown varies, but there is no point of principle upon which the various types of account differ.

This should save the student from the very common fear that "Company Accounts"—with which we shall henceforward be principally concerned—are based on entirely different principles, or that they follow an alternative system of book-keeping altogether. He may take it that, except for small matters on the assets side of the Balance Sheet, such as Discount on Debenture Issues, etc., "Company Accounts" relate entirely to the Share Capital and to the methods of dealing with the yearly and the accumulated profits or losses. In all other respects Company Accounts are identical —in principle—with the accounts of sole traders or partnerships.

SELF-EXAMINATION QUESTIONS. V

1. Explain briefly the use of a Trading and Profit and Loss Account.

2. What is a Balance Sheet and of what type of Ledger Accounts is it composed?

3. Explain briefly "Payment in Advance" and a "Reserve for Expenses Accrued due." How are they dealt with in the Ledger?

4. Show, by *pro forma* examples, the manner in which the Capital Accounts of partnerships and limited companies are included in Balance Sheets.

5. Messrs. Brown & Phillips are equal partners in a business trading under the style of The Pimlico Cycle Co. On the 31st December their book-keeper extracted the following balances from the books—

Cash at Bank, £3,990; Plant and Machinery, £6,880; Stock of Machines, 1st January, £7,858; Materials on hand, 1st January, £2,730; Sales during the year, £188,680; Sundry Debtors, £6,556; Agents' Commission, £4,890; P. Brown, Capital Account, £5,358; R. Phillips, Capital Account, £4,900; Workmen's Wages, £26,798; Business Premises, £2,500; Bills Payable; £3,840; Cash Creditor, £4,000; Materials Purchased, £139,920; Sundry Creditors, £4,462; General Expenses, £720; Travellers' Salaries, £3,520; P. Brown, Drawing Account, £1,120; R. Phillips, Drawing Account, £900; Bad Debts written off, £958; Rents, Rates, and Taxes, £1,900.

The following adjustments are necessary—

One year's Interest due to Cash Creditor at 5 per cent per annum; Commission due to Agents, £700.

The Stocks on hand at 31st December were—

Materials, £1,860; Machines, £6,250.

Prepare Trial Balance, Trading and Profit and Loss Account, and Balance Sheet as at 31st December.

Note. When preparing the Trial Balance, take care to group the expenses and income together, as explained in the chapter just read.

CHAPTER VI

CLASSIFICATION OF ASSETS AND DEPRECIATION

It has been mentioned that the order in which assets are " marshalled " in Balance Sheets differs according to whether the concern is owned by a company, a partnership, or a sole trader. This marshalling was, and still is, a matter of custom with sole traders and partnership. In the case of companies, however, the matter is—to some extent—governed by the Companies Act, 1929. This Act does not lay down the order in which assets shall appear in a Balance Sheet, but it does provide that the assets shall, to a certain extent, be classified. The exact effect of the provisions will be studied in a later chapter, but the principal accountancy classifications of assets forms the subject-matter of this chapter.

Classes of Asset.

All assets fall primarily into one or other of two main groups, which are known as—

(*a*) Fixed Assets. These are assets which are held, and are intended to be held, by a business, permanently, for the purpose of earning revenue.

(*b*) Floating Assets. These are assets which are continually changing their form during the process of earning revenue.

The distinction between the two groups will be made clear if the case of a manufacturing company's assets is considered. The company acquired, for the purpose of earning revenue, fixed assets in the form of a factory, machinery, lorries, horses, offices, warehouses, and miscellaneous equipment. These assets are retained in the business, and are not intended to be sold in the course of trading. They are, therefore, " fixed."

The same company then commences to trade, and with its cash buys its raw material. After a little while it finds that its production is continually turning into debtors, then into bills of exchange, and finally back into cash. These assets, which are continually changing their form in this way, are known as floating assets.

Other Designations of Assets.

Apart from the main classification of assets into fixed and floating, there are sundry other designations applied to assets. The reader need not regard these further designations as important classifications of assets; they are merely convenient terms for referring to the particular character of certain classes of assets—both fixed and floating. Bearing this in mind the more common of these subdivisions are set out below.

Liquid Assets. Assets that consist of cash or are capable of easy conversion into cash.

Wasting Assets. Assets that are gradually consumed during the process of earning revenue. This class includes such assets as patents, leases, mines, quarries, plant and machinery. In fact, the majority of fixed assets fall under the general designation of "wasting." The exceptions consist of freehold land and similar properties. The student should note, however, that some authorities insist that the only wasting assets are those which actually waste as they produce revenue, e.g. gold mines, and not those which are merely worn away, e.g. machinery.

Fictitious Assets. Accounts which, like debit balances in Profit and Loss Account, occasionally find themselves on the wrong side of the Balance Sheet, i.e. on the Assets side, or which, like Preliminary Expenses, are literally fictitious.

Depreciation.

This leads us to an important matter, which we have hitherto avoided, viz. Depreciation. It will be well

known to the reader that the assets of a business cannot possibly remain stable from year to year. Certain of the assets, such as Plant and Machinery, will wear away through use, and become less and less valuable as time goes on. Others, such as Leases, depreciate in value by the effluxion of time, not by wear and tear. Others, again, such as Investments, fluctuate in value from year to year according to their market value. Lastly, there are assets which lose their value through becoming obsolete or out of date.

It is clear that all these depreciations in value represent real losses to the proprietors of the businesses which own them. It is, therefore, necessary to debit the Profit and Loss Account each year, with a charge representing the diminutions in value. The corresponding credit is posted to the credit of each Asset Account concerned—thus reducing the amount on the debit and, consequently, the amount at which the asset appears in the Balance Sheet. In the examples of Balance Sheets which we have considered hitherto, we have ignored depreciation, but from now onward we shall take it into account. Having established the simplicity of the principle of depreciation, we may now proceed to study various—and, to the student, elaborate—methods of entering depreciation in the annual accounts.

Wear and Tear, Fluctuation, and Obsolescence.

It will be found that the terms used to denote depreciation vary considerably, according to the asset or class of asset concerned. The more common of these terms are as follows—

1. Wear and Tear. This term is applied to the wear and tear of such assets as Plant, Machinery, Furniture, etc. It is not commonly used commercially, but is reserved for the allowance granted by the Inland Revenue Authorities to cover depreciation.

2. FLUCTUATION. This term also is rarely included in accounts, but is used colloquially. Fluctuation in the value of investments is generally referred to in accounts as " Depreciation of Investments," or "Amount written off Investments," in the case of a fall in value; appreciation might be referred to as " increase in value of investments." In practice, however, it is unusual to take credit for unrealized profit represented by appreciation on investments.

3. OBSOLESCENCE. Obsolescence is also a term which is used colloquially. Where it occurs it will usually be found that the obsolete plant has been sold, and that the proceeds have been credited to the Asset Account. The balance remaining to the debit represents the obsolescence, but it is generally described in the accounts as " Loss on Sale of Plant."

4. AMORTIZATION. This term is applied to the depreciation of such assets as Leases, Patents, Copyrights, etc. These assets do not suffer wear and tear, but amortize by effluxion of time. In this case the loss is actually described as amortization, e.g. "Amortization of Lease."

Ascertainment of Depreciation.

Whilst we know that the loss called " Depreciation " is an actual loss, we have not yet considered the means of ascertaining its extent; in other words, we have not yet studied the means of determining the amount which should be charged to Profit and Loss Account to cover the annual loss in value. If we consider each asset separately, however, we find that a method of measuring the loss presents itself to us readily. The case of leases may be taken first.

Amortization of Leases.

As a lease becomes valueless at the end of a given period of years, it is clear that its value expires at a

rate represented by its cost divided by its total life. This annual amortization, being the amount lost each year, is obviously the amount to be charged to Profit and Loss Account. This is the simplest form of depreciation; it consists of nothing more than debiting the accounts with a fixed annual instalment. The instalment is arrived at by dividing by the number of years of the lease's life. Unfortunately, this simple form of depreciation is given an impressive title which, now that we are aware of its real simplicity, we may adopt. It is known as the "Fixed Instalment Method of Depreciation."

Machinery.

Whereas a lease may be supposed to give equal annual service, the same is not always true as regards other assets, such as Machinery. Apart from wear and tear, the Profit and Loss Accounts will always have to bear a charge in respect of repairs and renewals. These repairs are generally light during the early years of the machinery's life, and heavy in the later years. We are, therefore, forced to discover a means of apportioning the depreciation charge in such a way as to equalize the total expense of upkeep over the life of the asset. To do this means charging a heavier amount of depreciation in the early years in which the cost of repairs and upkeep will be small, and a lighter amount of depreciation in the later years in which the repairs will be costly.

Such a method is to be found by making a percentage deduction calculated on the diminishing value of the asset. Thus, in the case of a machine costing £100, an annual percentage deduction of 10 per cent would amount to £10 in the first year, £9 in the second year (10 per cent of £100 – £10), £8 2s. in the third year (10 per cent of £100 – £10 – £9), and so on. It will be seen that this method gives us what is required, a

reducing annual charge to the Profit and Loss Account. For most practical purposes it is sufficient for the secretary to calculate the appropriate percentage (10 per cent not necessarily being correct in all cases) by trial and error. In special cases—in which an exact calculation is required—the rate is obtained by this formula—

$$\text{Nil value at end of useful life} = \text{Value of machinery} \times \left(\frac{100 - x}{100}\right)^y$$

x = requisite percentage.

y = number of years of expected useful life.

This method of depreciation is known as the "Diminishing Balance Method."

Residual Value.

Certain assets, such as Leases and Patents, have no value whatever at the end of their term of life. Certain other assets, however, whilst of no value for their original purpose, possess some value even at the expiration of the term for which they have been usefully employed. Machinery, for example, will generally have a value as scrap after it has become worn out. This scrap value is known as "Residual Value," and should be taken into account when calculating depreciation. A simple way of taking it into account is to estimate its amount and deduct it from the value of the machinery on which depreciation calculations are to be made.

Interest on Asset Values.

Occasionally the secretary will be called upon to take the interest-earning capacity of assets into account, when preparing his depreciation schedules. This is usual in the case of costly leases and other expensive assets of a similar nature. The principle underlying the matter is that the capital which has been sunk would, if otherwise invested, be earning interest at the

current market rates, and that the asset must, therefore, be regarded as costing that much more. To give effect to the principle the Asset Account (e.g. the "Lease") is debited with interest at the agreed rate, calculated on the annual balance standing to the debit. The corresponding credit is taken (via "Interest Account") at the end of the year, to Profit and Loss Account. The Asset Account is then reduced by a fixed annual charge for depreciation.

It will be seen that whilst the annual debit to Profit and Loss Account will always be the same, the amount credited by way of interest will always be diminishing. This is correct, as the capital invested in the asset is being gradually amortized.

This method of taking interest into account before calculating depreciation is known as the "Annuity System of Depreciation."

Revaluation of Assets.

There are certain types of assets which do not lend themselves readily to any of the foregoing methods of depreciation. Such items as casks, loose tools, packages, timber, moulds, and patterns cannot be treated in the same way as fixed machinery. They are, therefore, checked over physically each year, listed and valued. The valuations are then compared with the values appearing in the Private Ledger. The differences are then written off to Profit and Loss Account and credited to the various assets concerned, thus reducing the balances on the accounts to agree with the revaluations. This method is known as the "Revaluation Method."

Illustrations.

The following examples illustrate the methods of depreciation with which we have been dealing—

1. Fixed Instalment Method. The X Y Z Co.,

X Y Z CO., LTD.

LEASEHOLD PREMISES ACCOUNT

Dr. *Cr.*

1930			£	s.	d.	1930			£	s.	d.
Jan. 1	To Cash (Purchase of Lease) .	C.B. 40	1,500	–	–	Dec. 31	By Profit and Loss Account—Amortization of Lease for year to date . .	J. 14	150	–	–
						,, 31	,, Balance . . .	c/d	1,350	–	–
			£1,500	–	–				£1,500	–	–
1931						1931					
Jan. 1	To Balance . . .	b/d	1,350	–	–	Dec. 31	By Profit and Loss Account—Amortization of Lease for year to date . .	J. 52	150	–	–
						,, 31	,, Balance . . .	c/d	1,200	–	–
			£1,350	–	–				£1,350	–	–
1932											
Jan. 1	To Balance . . .	b/d	1,200	–	–						

Ltd., owns a lease of a factory for 10 years from 1st January, 1930, at a rental of £100 per annum payable to the A B C Co., Ltd. The lease cost £1,500. It is desired to show the entries in the Ledger for the first two years, ignoring income-tax (see pages 75 and 77).

Some secretaries prefer to debit all depreciation and amortization to a Depreciation Account before transferring it to Profit and Loss Account. If this method is adopted the entry in the Leasehold Premises Account will read " By Amortization Account (or Depreciation Account), Amortization of Lease for year to date, £150." The Depreciation Account—which is merely a summarizing account—appears on page 77.

2. Diminishing Balance Method. The M B Co., Ltd., wishes to depreciate an excavator which has been purchased for £10,000. The machinery has a life of eight years. At the end of that time it will be taken back by the manufacturers, who will allow 25 per cent discount off the price of a more elaborate machine costing £10,900.

The rate at which the depreciation is to be charged is arrived at as follows—

$$25 \text{ per cent of } £10{,}900 = £10{,}000 \times \left(\frac{100 - x}{100}\right)^8$$

x = rate per cent = 15 (approx.).

and the Excavator Account appears on pages 78 and 79.

3. The Annuity System. The Excelsior Co., Ltd., purchases a lease for £10,000, and wishes to depreciate it in equal annual instalments over its life of 10 years after charging the asset with interest at 5 per cent.

The secretary will find it useful to employ interest tables in making the calculations such as are involved in this example. The 5 per cent interest table shows that the annual instalment which will write off £1 in 10 years is £·129504. The instalment on £10,000 is,

OTHER ACCOUNTS IN BOOKS OF THE X Y Z CO., LTD.

THE A B C CO., LTD.

Dr. *Cr.*

1930		C.B.	£	s.	d.	1930			£	s.	d.
Dec. 31	To Cash	14	100	–	–	Dec. 31	By Rent for year to date	J.20	100	–	–
			£100	–	–				£100	–	–
1931						1931					
Dec. 31	To Cash	C.B. 34	100	–	–	Dec. 31	By Rent for year to date	J. 50	100	–	–
			£100	–	–				£100	–	–

DEPRECIATION ACCOUNT

1930			£	s.	d.	1930			£	s.	d.
Dec. 31	To Transfer from Leasehold Premises Account—Amortization for year to date	J. 4	150	–	–	Dec. 31	By Profit and Loss Account	J. 9	150	–	–
			£150	–	–				£150	–	–

THE M. B. CO., LTD.
EXCAVATOR ACCOUNT

Dr. *Cr.*

1930		£	s.	d.	1930		£	s.	d.
Jan. 1	To Cash—Cost of Excavator . .	10,000	–	–	Dec. 31	By Profit and Loss Account—15 per cent Depreciation . . .	1,500	–	–
					,, 31	,, Balance . . . . c/d	8,500	–	–
		£ 10,000	–	–			£ 10,000	–	–
1931					1931				
Jan. 1	To Balance . . . . b/d	8,500	–	–	Dec. 31	By Profit and Loss Account—15 per cent Depreciation . . .	1,275	–	–
					,, 31	,, Balance . . . . c/d	7,225	–	–
		£8,500	–	–			£8,500	–	–
1932					1932				
Jan. 1	To Balance . . . . b/d	7,225	–	–	Dec. 31	By Profit and Loss Account—15 per cent Depreciation . . .	1,083	15	–
					,, 31	,, Balance . . . . c/d	6,141	5	–
		£7,225	–	–			£7,225	–	–
1933					1933				
Jan. 1	To Balance . . . . b/d	6,141	5	–	Dec. 31	By Profit and Loss Account—15 per cent Depreciation . . .	921	3	9
					,, 31	,, Balance . . . . c/d	5,220	1	3
		£6,141	5	–			£6,141	5	–

Dr. **EXCAVATOR ACCOUNT** *(continued)* *Cr.*

1934			£	s.	d.	1934		£	s.	d.
Jan. 1	To Balance	b/d	5,220	1	3	Dec. 31	By Profit and Loss Account—15 per cent Depreciation	783		3
						,, 31	,, Balance c/d	4,437	1	–
			£5,220	1	3			£5,220	1	3
1935						1935				
Jan. 1	To Balance	b/d	4,437	1	–	Dec. 31	By Profit and Loss Account—15 per cent Depreciation	665	11	2
						,, 31	,, Balance c/d	3,771	9	10
			£4,437	1	–			£4,437	1	–
1936						1936				
Jan. 1	To Balance	b/d	3,771	9	10	Dec. 31	By Profit and Loss Account—15 per cent Depreciation	565	14	6
						,, 31	,, Balance c/d	3,205	15	4
			£3,771	9	10			£3,771	9	10
1937						1937				
Jan. 1	To Balance	b/d	3,205	15	4	Dec. 31	By Profit and Loss Account—15 per cent Depreciation	480	17	3
						,, 31	,, Balance c/d	2,724	18	1
			£3,205	15	4			£3,205	15	4
1938						1938				
Jan. 1	To Balance	b/d	2,724	18	1	Jan. 1	By Transfer to New Excavator Account, being 25 per cent Allowance against New Machine	2,725	–	–
,, 1	,, Profit and Loss Account Adjustment			1	11					
			£2,725	–	–			£2,725	–	–

THE EXCELSIOR CO., LTD.

LEASEHOLD PREMISES ACCOUNT

Dr. *Cr.*

1930			£	s.	d.	1930			£	s.	d.
Jan. 1	To Cash		10,000	–	–	Dec. 31	By Amortization transferred to Profit and Loss Account		1,295	–	10
Dec. 31	,, Interest at 5 per cent		500	–	–	,, 31	,, Balance	c/d	9,204	19	2
		£	10,500	–	–			£	10,500	–	–
1931			£	s.	d.	1931			£	s.	d.
Jan. 1	To Balance	b/d	9,204	19	2	Dec. 31	By Amortization transferred to Profit and Loss Account		1,295	–	10
Dec. 31	,, Interest at 5 per cent		460	4	11	,, 31	,, Balance	c/d	8,370	3	3
		£	9,665	4	1			£	9,665	4	1
1932											
Jan. 1	To Balance	b/d	8,370	3	3						

(*Note.* The interest is either transferred to the credit of Interest Account or to the credit of Profit and Loss Account direct.)

6—(2039)

THE JAMESON CO., LTD.

LOOSE PLANT AND TOOLS ACCOUNT

Dr. *Cr.*

1930		£	s.	d.	1930		£	s.	d.
Jan. 1	To Value of Loose Plant and Tools at this date	1,000	10	4	Dec. 31	By Valuation of Loose Plant and Tools carried down	1,209	17	8
Dec. 31	,, Purchases during year	400	8	3	,, 31	,, Depreciation carried to Profit and Loss Account	191	—	11
		£1,400	18	7			£1,400	18	7
1931									
Jan. 1	To Balance b/d	1,209	17	8					

therefore, £1,295·04, and the account for the first two years will be as shown on page 80.

The effect of the annual charge for the whole of the 10 years will be seen from the following table—

	Balance	Interest	Total	Instal-ment	Balance
	£	£	£	£	£
3rd year .	8,370·17	418·50	8,788·67	1,295·04	7,493·63
4th year .	7,493·63	374·66	7,868·29	1,295·04	6,573·25
5th year .	6,573·25	328·66	6,901·91	1,295·04	5,606·87
6th year .	5,606·87	280·34	5,887·21	1,295·04	4,592·17
7th year .	4,592·17	229·60	4,821·77	1,295·04	3,526·73
8th year .	3,526·73	176·33	3,703·06	1,295·04	2,408·02
9th year .	2,408·02	120·40	2,528·42	1,295·04	1,233·38
10th year .	1,233·38	61·66	1,295·04	1,295·04	Nil

4. The Revaluation Method. The Jameson Co., Ltd., owns Loose Plant and Tools on 1st January, 1930, valued at £1,000 10s. 4d. It purchases further tools at a cost of £400 8s. 3d. during the year 1930. At the end of the year the tools are listed and valued and found to be worth £1,209 17s. 8d. (see page 81).

SELF-EXAMINATION QUESTIONS. VI

1. Explain fully the distinction between Fixed and Floating Assets.

2. What is Depreciation? How is its name changed according to the asset concerned?

3. Explain the difference between the " Fixed Instalment " and the " Diminishing Balance " methods of depreciation.

4. What is the Annuity System? Explain the principle upon which it is based.

5. The M. B. Co., Ltd., finds that to depreciate its machinery (costing £14,298 7s. 3d.) by the diminishing balance method over a term of 15 years, requires an annual charge of 12½ per cent. What is the estimated residual of the machinery? Show the necessary entries in the books of the company.

CHAPTER VII

RESERVES AND FUNDS

We have already touched upon the subject of reserves when dealing with accrued liabilities. It is now necessary to study more closely the different types of reserves which the secretary encounters.

Simple Reserves.

Ordinary or simple reserves are provisions made in the accounts for anticipated losses or expenses. They are charges against the profits which must be entered in the Profit and Loss Account in order to avoid showing as profit an amount which has not actually been earned. Instances of common reserves are to be found in "Reserve for Audit Fees," "Reserve for Discounts," "Reserve for Bad Debts," "Reserve for Rates Accrued Due," etc. The reader should experience no difficulty in dealing with these. The amounts involved are calculated and then either entered in the Ledger as a debit to the Expense Account concerned and against a credit to the account of the creditor, or included in the Trial Balance in the manner explained in earlier chapters.

Appropriations of Profit.

As distinct from ordinary reserves there are also reserves which are in the nature of appropriations of profit. Assuming that the X Y Co., Ltd., has prepared its annual accounts and that after charging all possible expenses, it is left with a profit on Profit and Loss Account of £5,500. It decides to place £3,000 to General Reserve and to pay a dividend absorbing £2,500. In this case the £3,000 represents an "appropriation of profit" to reserve.

General Reserves.

It is very necessary for the reader to appreciate the object of such appropriations to reserve before proceeding to study Specific Reserves. For this purpose we set out on page 85 a simple *pro forma* Balance Sheet of the X Y Co., Ltd.

A glance at this *pro forma* Balance Sheet tells us several things. Firstly, although a profit of £5,500 is available for withdrawal as dividend, there is not enough cash to meet such a distribution. Secondly, provision must be made for creditors amounting to £1,500. If these two points are taken together it will be seen that the utmost amount of cash which can be taken out of the business (by way of dividend) is £2,500. There remains, therefore, £3,000 of profit which is locked up in stock, debtors, or leasehold buildings. It is this sum which the X Y Co., Ltd., decides to appropriate to reserve, and the amount then appears as "General Reserve, £3,000." The object of the transfer is to conserve in the business as much of the profit as cannot be withdrawn without serious consequence.

Reserves for Contingencies.

It must not be thought that general reserves are created solely on the grounds set out above. Occasionally the directors of companies have to take into account such contingencies as future adverse trading prices or possible decreases of profit through fierce competition. These and a hundred other circumstances may lead them to refrain from dividing profits "up to the hilt." The procedure is exactly the same as in the example we have considered.

It will be appreciated that the Balance Sheet of a company desiring to conserve profits which it could distribute, differs from that of a company which has no available cash. Both companies may have made an

THE X Y CO., LTD.

"PRO FORMA" BALANCE SHEET AS AT 31st DECEMBER, 193..

Liabilities	£	s.	d.	£	s.	d.	Assets	£	s.	d.
Capital Authorized and Issued				4,000	–	–	Leasehold Premises at Cost	2,000	–	–
5 per cent Debentures				1,000	–	–	Stock-in-trade	3,500	–	–
Creditors				1,500	–	–	Debtors	2,500	–	–
General Reserve				3,000	–	–	Cash at Bank	4,000	–	–
Profit and Loss Appropriation Account	5,500	–	–							
Less Transfer to General Reserve	3,000	–	–							
				2,500	–	–				
				£12,000	–	–		£12,000	–	–

equal amount of profit. One, such as the X Y Co. Ltd., which we have considered, has locked up its profit —permanently or temporarily—in assets other than cash. The other may have a cash balance greater than the profit standing to the credit of its Profit and Loss Account. The first company transfers £3,000 to General Reserve because it is practically forced to do so. The second only follows this course voluntarily in order to conserve the cash. It may even decide to ensure that the cash shall be available for contingencies by investing it in gilt-edged securities. If it does so, the Reserve Account is known as a Reserve Fund, and the investments which it represents are called "Reserve Fund Investments."

Specific Reserves. General reserves are understood to be available for the general strengthening of a business or for meeting any unforeseen contingencies which may arise. It is, therefore, desirable that if provision has to be made for definite future changes of circumstances (as distinct from provision for present known liabilities) Specific Reserve Accounts should be created.

Repayment of Debentures.

The creation of a reserve to repay debentures is, perhaps, the commonest of the Specific Reserves to repay liabilities. We may use the simple *pro forma* Balance Sheet of the X Y Co., Ltd., which we employed to illustrate the creation of a General Reserve. That company has a debenture debt of £1,000 which, we will assume, is repayable in seven years' time at par. The directors could adopt any one of several courses to provide for this ultimate liability. They could set aside one-seventh of £1,000 out of their profits annually (i.e. out of £5,500 in the illustration), or they could set aside the whole amount in a good year. In any case the provision would be an Appropriation of Profit and not a charge against the Profit and Loss

Account. This is the important point for the secretary to bear in mind. The probable course they will adopt is to build up their Debenture Redemption Account (as it is called) by annual instalments based on sinking fund tables. In this way due regard will be paid to the interest which should be running on the profits retained in the business.

Debenture Redemption Account.

If it is decided to create a Redemption Account which shall allow interest at 5 per cent, then the following procedure is adopted. The 5 per cent table shows that £1 is produced in seven years by the annual investment of £·122819. The debentures of the X Y Co., Ltd., will, therefore, be provided for by the setting aside annually of £122 16s. 5d. In each year the Appropriation Account (not the Profit and Loss Account) is debited with this instalment, and a corresponding credit is made to "Debenture Redemption Account." In addition, interest at 5 per cent is added to the Redemption Account and debited to Appropriation Account. In this way the Debenture Redemption Account gradually mounts up until the total to its credit at the end of seven years is £1,000. This may be seen from the following table—

	Opening Balance	Instalment	Total	Interest	Carried Forward
	£	£	£	£	£
1st year .	Nil	122·819	122·819	6·141	128·960
2nd year .	128·960	122·819	251·779	12·589	264·368
3rd year .	264·368	122·819	387·187	19·360	406·547
4th year .	406·547	122·819	529·366	26·469	555·835
5th year .	555·835	122·819	678·654	33·933	712·587
6th year .	712·587	122·819	835·406	41·771	877·177
7th year .	877·177	122·823	1,000·000	—	—

Repayment of Debentures.

At the end of the period during which the Debenture Redemption Account has been built up, the business will have retained profits equal to the Redemption

Account. These profits, which might otherwise have been distributed as dividend, are available for the repayment of the debentures held by the various debenture holders. The Ledger entries, on the payment, will be "Debentures Account, *Dr*" and "Cash, *Cr.*" The debit to Debentures Account will, of course, close the account, whilst a balance equal to the amount of the debentures repaid will remain on the Debenture Redemption Account. This account, having fulfilled its purpose, is no longer required. The secretary then brings the matter before his board of directors, who usually decide to change the name of the account to "Special Reserve" or "Capital Reserve." It should not be transferred to Profit and Loss Account and treated as available for distribution, as the cash resources it represented have been withdrawn and paid away to the debenture holders. A *pro forma* Balance Sheet of the X Y Co., Ltd., is again set out to illustrate the foregoing procedure. It is given in columnar form in order to show the effect of the repayment, on page 89.

Conservation of Cash.

Our study of Reserve Accounts has so far been conducted on very simple lines, and we must now consider the slightly more difficult practical points surrounding them. The first matter which naturally catches the attention of the secretary, in the example given, is the difficulty of conserving cash in the business equal to the ever-growing Debenture Redemption Account. It is true that the debentures to be repaid do not amount to more than £1,000. In practice, however, it must be remembered that elaborate Redemption Accounts are only opened for much larger amounts. This being so, it can hardly be expected that the companies concerned will retain large cash balances to meet the ultimate payment to the debenture holders. What happens, in practice, is that cash equal to each annual

THE X Y CO., LTD.

"PRO FORMA" BALANCE SHEET AS AT 31st DECEMBER, 193..

Liabilities	Before Repayment	After Repayment	Assets	Before Repayment	After Repayment
	£	£		£	£
Capital Authorized and Issued	4,000	4,000	Leasehold Premises	2,000	2,000
5 per cent Debentures	1,000	Nil	Stock-in-trade	3,500	3,500
Creditors	2,000	2,000	Debtors	1,000	1,000
Debenture Redemption Account	1,000	Nil	Cash at Bank	4,000	3,000
Capital Reserve	Nil	1,000			
Profit and Loss Appropriation Account	2,500	2,500			
	£10,500	£9,500		£10,500	£9,500

instalment is put aside, and invested in securities calculated to return the required amount of interest (in the example, 5 per cent). The annual investment is debited to a "Debenture Redemption Investment Account." At the end of the period the investments, which should equal approximately the Redemption Account, are realized and the cash is utilized to repay the debenture holders.

Treatment of Interest.

It will be remembered that when the Debenture Redemption Account was retained in the business, it was necessary to credit it annually with interest at the agreed rate and to debit the Appropriation Account. When the Debenture Redemption instalments are invested in outside securities the dividends received are debited in the Cash Book as and when they are received, and credited to the Debenture Redemption Account. The secretary should, therefore, bear in mind that he must invest, each year, not only the instalment (which, in our illustration, was £122·819), but also an amount equal to the dividends received on the Debenture Redemption Account's investments.

Investment in Insurance Policies.

In view of the fact that it is extremely difficult to arrange the investment of the moneys at rates calculated to give the exact return required, the secretary sometimes has recourse to the "Insurance Policy Method." Under this method an annual sum is paid to a selected insurance company. At the maturity of the policy the company receives, from the insurance company, a cheque for the amount insured. This cash is then utilized for the redemption of debentures, or for whatever similar purpose the policy was taken out.

The entries in the books are no more involved, under this system, than under the two alternative methods

already discussed. The annual additions to the account are made by debiting Appropriation Account and crediting the Redemption Account. Then an account is opened in the name of the insurance company, which is debited with the annual payments made to it on account of the policy.

Funds.

Whenever specific reserves, such as those we have been considering in this chapter, are invested outside the business, they should properly be referred to as "Sinking Funds." Some secretaries prefer not to do so, although theoretically it is correct. Students who intend taking secretarial examinations in book-keeping must, under all circumstances, adopt the word "Fund." Thus, in the examples we have considered, the "Debenture Redemption Account" would, for examination purposes, be called the "Debenture Redemption Fund Account," provided the instalments were invested in outside securities or in an insurance policy. Similarly, the "Debenture Redemption Investment Account," which was dealt with on page 90, would be called, in examination papers, "Debenture Redemption Fund Investment Account."

Replacement of Assets.

There now remains to be considered a matter which is ordinarily treated under the heading of "Depreciation." It is the replacement of assets by means of sinking funds. On page 86 we referred to specific reserves to repay liabilities, and in the subsequent pages we explained the methods by which they were built up. We have now to explain that funds may also be built up in the same way to replace assets at the end of their useful life. There is only one difference—the instalments to such funds are charges to Profit and Loss Account, and not appropriations of realized profit.

An example of a fund to replace an asset may be found in the *pro forma* Balance Sheet already considered. The X Y Co., Ltd., owns leasehold premises which cost £2,000. The directors may decide to amortize this lease over its life of seven years on the lines shown in the first illustration in Chapter VI, namely, by the " Fixed Instalment " method. Or they may choose to follow the third illustration, under the "Annuity System." In either case the lease would be written off the books at the end of seven years by means of the appropriate annual charges to Profit and Loss Account. But when that time arrives the company would find itself without alternative premises, and the continuance of the business might be jeopardized. To meet this situation the company follows the same procedure it adopts in the case of a fund for the repayment of a liability, i.e. it opens a " Depreciation Fund " or an " Insurance Policy Account." We have dealt with these two matters fully earlier in the chapter and there is, therefore, no need to consider them again at this stage. The annual instalments to the Depreciation Fund, or the annual payments to the insurance company, are treated exactly as before. On maturity, however, there is a slight difference in the procedure. If the asset under treatment is the lease of the X Y Co., Ltd., then the credit on " Leasehold Redemption Fund Account," which will amount to £2,000 after seven years, will be utilized to write off the " Leasehold Premises Account " entirely. It will be remembered that in the case of a fund built up to repay liabilities, the accumulated balance—representing profits conserved—was left on the books and treated as a reserve. In this case it is composed of charges against profits, and as it represents " accumulated depreciation," it must be used to extinguish the asset which ceases to exist at the end of the period of the lease.

The investments which have been accumulated, or

the insurance policy which now matures, are available for the purchase of a new lease by the X Y Co., Ltd., at a price of £2,000.

Summary of Rules.

As in the case of other subjects dealt with in previous chapters, the rules relating to reserves and funds may be summarized as under—

1. Simple Reserves.

Debit the Expense Account concerned and credit the supplier or "Accrued Expenses Account" or "Sundry Creditors' Account."

2. General Reserve Account.

Debit Appropriation Account and credit "General Reserve Account" or "Reserve Account."

3. Specific Reserve Accounts.

(*a*) *For the Repayment of Liabilities.* Debit Appropriation Account and credit the Redemption Account, e.g. "Debenture Redemption Account."

(*b*) *For the Replacement of Assets.* Debit Profit and Loss Account and credit the Redemption Account, e.g. "Leasehold Redemption Account."

4. The Conservation of Cash.

(*a*) Invest annually a sum equal to the amount appropriated to the Redemption Account, together with the interest arising on the investments.

(*b*) Purchase an insurance policy on which the annual premiums will provide a lump sum payment equal to the amount required at the appropriate time.

(*c*) On maturity of the Redemption Account relating to a liability, utilize the cash for the repayment, but transfer the Redemption Account to a Special or a Capital Reserve. If the account relates to an asset, utilize it to extinguish the asset concerned, and employ the cash to replace it by, e.g. further machinery or a new lease, as the case may be.

SELF-EXAMINATION QUESTIONS. VII

1. Give definitions of, and differentiate, the following terms: (*a*) Reserve, (*b*) Reserve Fund, and (*c*) Sinking Fund.

2. A company having a lease standing in their books at £5,000 decide to provide for depreciation by taking out a policy for Leasehold Redemption. How would you deal with the annual premiums in the books, and how would you adjust the accounts when the lease expires and the policy matures?

3. The Y Co., Ltd., has an available profit of £44,000, but its assets, which amount to £100,000, do not include any cash. The creditors total £10,000 and the Issued Capital £46,000. What procedure would you recommend? Give the Journal entry, or entries, entailed by your recommendations.

4. In the circumstances given in Question 3, but assuming that the company had a cash balance of £23,000 and that it is desired to pay a dividend of 50 per cent only, what alternative methods of procedure could be followed?

5. Machinery is bought for £3,000. Its life is estimated to be 6 years, and its residual value at the end of that time £534. Show the Plant and Machinery Account for the 6 years, writing off depreciation at a fixed rate per cent on the reducing value of the asset.

SECTION II
COMPANY ACCOUNTS

CHAPTER VIII

THE SHARE CAPITAL ACCOUNTS OF COMPANIES

We dealt briefly in an earlier chapter with the nature of a company's Capital Account. We saw that it represented the amount invested by the shareholders, and was comparable with the Capital Account of a sole trader or with the Partners' Capital in a partnership. It is now necessary to explain that as a company may have many thousands of shareholders whilst a partnership has no more than twenty members, the recording of changes in a company's capital is sometimes slightly more involved.

Small Capital Companies.

Companies in which the capital is very small or in which there are very few members are able to keep very simple records of the amount contributed by each shareholder. The cash provided by each of them is debited in the Cash Book and credited to the Share Capital Account. A record of the name and address of each shareholder is then entered in a book (not a book of account) called the " Register of Members," to which further reference will be made later. Apart from these entries there is little else for the secretary to attend to.

Large Capital Companies.

The capital accounts of larger companies or of public companies are generally more elaborate. On no account, however, need the secretary regard them as difficult. He may find it necessary to open an "Application and Allotment Account," a " First Call Account,"

" Second Call Account," " Final Call Account," " Forfeited Shares Account," and so on, but if he understands the simple principles involved, he can never be mystified by the entries he may have to make.

The Uses of " Call Accounts."

The shareholders of companies are not always called upon to contribute the full nominal amount of their shares in one amount. The directors of the Excel Co., Ltd., may decide to arrange, for example, that applicants applying for an issue of 100,000 shares of £1 each in their company shall pay for them as follows—

1. On Application	. . .	2s. 6d. per share
2. On Allotment	. . .	2s. 6d. ,, ,,
3. As a First Call (One month later)	. . .	5s. od. ,, ,,
4. As a Second Call (One month after the first)	. . .	5s. od. ,, ,,
5. As a Final Call (One month after the second)	. . .	5s. od. ,, ,,

It would be quite possible to post all cash received during the three months direct to the credit of " Share Capital Account." The reader will appreciate, however, that to do so is to run a grave risk of making many mistakes. Some of the shareholders—in the example quoted—might overlook the dates of the calls; others might pay the final call but forget to pay the second; others again might pay the Application and Allotment money and fail altogether to pay the balance of the nominal amount due on their shares. In addition, there is the possibility that more shares may be applied for than are offered, thus necessitating the return of the Application money to those applicants to whom no allotment is made. A brief consideration of these complications serves to show that the secretary of the Excel Co., Ltd., could not hope to keep track of the issue of the 100,000 shares of his company if all cash receipts were posted indiscriminately to " Share Capital Account."

The method he adopts is as follows—

1. The cash received in respect of each section of the issue—or "call," as it is termed— is debited in the Cash Book and credited to a separate Call Account, one of which is opened for each call.

2. The full amount due on each "call" is credited to Share Capital Account, the corresponding debit being made to the call account concerned.

This step will be understood if the reader assumes that the full amount of cash receivable on a call has been duly collected and posted to the credit of the Call Account. If such is the case then the debit to the Call Account and the credit to Share Capital Account might be described as a "transfer" of the cash so received from its temporary to its final resting place—"Share Capital Account." This explanation is only given to make clear the meaning of Step 2; in practice, the credit to Share Capital Account precedes the receipt of the cash.

3. If shareholders over-pay, or make payments in respect of late calls simultaneously with their payments on earlier calls, the adjustments are made in the Call Accounts concerned. The Share Capital Account is kept free of all these adjustments.

Illustration of Share Issue.

In order to illustrate the practical application of the three steps set out above the issue by the Excel Co., Ltd., is set out below. The dates and amounts of the calls are those given on page 96. The following complications are assumed to enter into the issue—

1. In response to an offer of 100,000 shares of £1 each at par, applications for 150,000 shares are received. The forms in respect of 250 shares are accompanied by payments of 5s. per share and those for 100 by payments of 10s. per share, instead of 2s. 6d. only.

2. The directors allot 100,000 shares to applicants,

including the 350 shares on which overpayments are made. The applicants for these shares request the company to retain the over-payments against the amounts due on other calls.

3. The first call is duly made and is settled without complication, but in the second call a shareholder holding 1,000 shares sends in his final call at the same time. The final call is settled except that a holder of 5,000 shares is in arrear with his call when the secretary takes out a Balance Sheet a fortnight later. This Balance Sheet will show that the whole of the authorized capital of the company, £300,000, has now been issued. The illustrations are given on pp. 99 to 101.

The following entries relating to Capital will appear in the Balance Sheet taken out by the secretary on 15th April—

LIABILITIES

	£ s. d.	£ s. d.
Authorized Capital—		
300,000 Shares of £1 each . .	300,000 – –	
Issued Capital—		
300,000 Shares of £1 each fully called	300,000 – –	
Less Calls in Arrear . . .	1,250 – –	
		298,750 – –

FORFEITURE OF SHARES. A shareholder's calls in arrear, which, as will be seen from the above example, are shown as a deduction from the Issued Share Capital, cannot be allowed to remain outstanding indefinitely. The secretary naturally employs all possible means to collect the calls, but should he fail then the company has recourse to forfeiture; that is to say, it proceeds to declare "forfeit" the whole of the interest of the shareholder in the particular shares. This method of dealing with delinquent shareholders is usually authorized under the company's Articles of Association. If the Articles are silent then the procedure is governed by Clauses 23 to 29 of the First Schedule ("Table A")

THE EXCEL CO., LTD.

APPLICATION AND ALLOTMENT ACCOUNT

Dr. *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Jan. 1	To Issued Share Capital Account: 5s. per share on 100,000 Shares (2s. 6d. on Application and 2s. 6d. on Allotment)	Jnl.	25,000	–	–	Jan. 1 to 31	By Cash: 2s. 6d. per Share received from Applicants for 149,650 Shares	C.B.	18,706	5	–
,, 1 to 31	,, Cash: 2s. 6d. Application money on 50,000 Shares returned to applicants	C.B.	6,250	–	–	,, ,,	,, Cash: 5s. per Share received from Applicants for 250 Shares	C.B.	62	10	–
,, ,,	,, Transfer overpayment of 5s. per share on 100 Shares to "First Call Account"	Jnl.	25	–	–	,, ,,	,, Cash: 10s. per Share received from Applicants for 100 Shares	C.B.	50	–	–
						,, ,,	,, Cash: 2s. 6d. per Share in respect of Allotment money on 99,650 Shares	C.B.	12,456	5	–
			£31,275	–	–				£31,275	–	–

Dr. **FIRST CALL ACCOUNT** *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Feb. 1	To Issued Share Capital Account: 5s. per Share on 100,000 Shares . .	Jnl.	25,000	–	–	Jan. 1	By Transfer of Overpayment of 5s. per Share on 100 Shares on "Application and Allotment" . .	Jnl.	25	–	–
						Feb. 1 to 28	By Cash: 5s. per Share received on 99,900 Shares .		24,975	–	–
			£25,000	–	–				£25,000	–	–

Dr. **SECOND CALL ACCOUNT** *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Mar. 1	To Issued Share Capital Account: 5s. per Share on 100,000 Shares . .	Jnl.	25,000	–	–	Mar. 1 to 31	By Cash: 5s. per Share received on 99,000 Shares	C.B.	24,750	–	–
,, 31	,, Transfer of Overpayment of 5s. per Share on 1,000 Shares to Final Call Account . . .	Jnl.	250	–	–	,, ,,	,, Cash: 10s. per Share on 1,000 Shares . .	C.B.	500	–	–
			£25,250	–	–				£25,250	–	–

Dr. **FINAL CALL ACCOUNT** *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Apr. 1	To Issued Share Capital: 5s. per Share on 100,000 Shares . . .	Jnl.	25,000	–	–	Mar. 31	By Transfer of Overpayment of 5s. per Share on 1,000 Shares on "Second Call Account" .	Jnl.	250	–	–
						Apr. 1 to 15	By Cash: 5s. per Share received on 94,000 Shares	C.B.	23,500	–	–
						,, 15	,, Call in Arrear . .	c/d	1,250	–	–
			£25,000	–	–				£25,000	–	–
193.. Apr. 15	To Call in Arrear . .	b/d	1,250	–	–						

Dr. **ISSUED SHARE CAPITAL ACCOUNT** *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Apr. 1	To Balance	c/d	300,000	–	–	Jan. 1	By Balance at this date.		200,000	–	–
						,, 1	,, Issue made on 1st Jan. as follows—				
						Jan. 1	Application and Allotment Account	Jnl.	25,000	–	–
						Feb. 1	First Call . .	,,	25,000	–	–
						Mar. 1	Second Call . .	,,	25,000	–	–
						Apr. 1	Final Call . .	,,	25,000	–	–
			£300,000	–	–				£300,000	–	–
						193.. Apr. 1	By Balance . . .	b/d	300,000	–	–

of the Companies Act, 1929. These clauses lay down certain routine procedure which must be followed very carefully, e.g. the shareholder must be given a final opportunity of paying the outstanding calls before he is deprived of all title to the shares.

The accounting entries arising from a forfeiture of shares are easy to follow if these two points are borne in mind—

1. The forfeiture entails the complete cancellation of the credit which has been made to Share Capital Account in respect of the shares to be forfeited; the debit outstanding on the Call Account must also be disposed of.

2. The amount paid in by the shareholder prior to the call in respect of which he defaulted constitutes a capital profit; it must be transferred to the credit of " Forfeited Shares Account."

Illustration of Forfeiture.

The case of the Excel Co., Ltd., may be used to illustrate the recording of a forfeiture. We will assume that the directors, having applied unsuccessfully for the payment of the £1,250 outstanding on final Call Account, decide to declare forfeited the 5,000 shares to which the call in arrear relates—

The simple Journal entry given on page 103 and marked "A" fulfils both points specified above, viz—

1. The Issued Capital Account of the Excel Co., Ltd., is reduced by the cancellation of 5,000 shares. The capital is left at £295,000. The posting of £1,250 to the credit of " Final Call Account " clears the debit standing on it—known as " Calls in Arrear."

2. The credit of £3,750, which is posted to " Forfeited Shares Accounts " constitutes capital reserve, and is shown on the liabilities side of subsequent Balance Sheets.

A.—JOURNAL ENTRY RECORDING FORFEITURE

193..			£	s.	d.	£	s.	d.
Apr. 30	Issued Share Capital	*Dr.*	5,000	–	–			
	To Final Call Account					1,250	–	–
	,, Forfeited Shares Account					3,750	–	–
	For forfeiture of 5,000 Shares allotted to Mr. X Y on 8th Jan., declared forfeited by reason of non-payment of Final Call of 5s. per Share (Board Minute No. —, Date ————.)							

B.—JOURNAL ENTRY RECORDING REISSUE OF FORFEITED SHARES

193..			£	s.	d.	£	s.	d.
May 10	Mr. A B	*Dr.*	1,250	–	–			
	Forfeited Shares Account		3,750	–	–			
	To Issued Share Capital					5,000	–	–
	For the issue of 5,000 Shares to Mr. A B at 5s. per Share, to be credited with 15s. per Share standing on Forfeited Shares Account, (Board Minute No.—, Date———.)							

Reissue of Forfeited Shares.

The Articles of Association of a company usually provide that forfeited shares may be reissued. The reissue may be made at any price provided always that the full nominal value at least is received by the company. The balance on forfeited shares account may be included in the calculations for this purpose. Thus, in the case we have considered the 5,000 shares may be sold to applicants offering, say, 5s., 6s., 7s. 6d., 10s., or so on per share. Any of these amounts added to the 15s. per share standing on Forfeited Shares Account would make up at least the full nominal price of the shares, i.e. £1. But an offer of, say, 2s. 6d. or some other sum less than 5s. could not be accepted. Were the company to accept 2s. 6d. each for the shares it would have received no more than 17s. 6d. in all for each £1 share. This would constitute an issue of shares at a discount which is illegal except under the very special provisions of Sect. 47 of the Companies Act, 1929.

The Journal entry on page 103, marked "B," illustrates the reissue of the 5,000 shares to an applicant who has offered 5s. per share.

Profit on Reissue of Shares.

If the reissue of the 5,000 shares by the Excel Co., Ltd., had been made to an applicant at 10s. per share then a profit of 5s. per share would have accrued to the company. This profit is known as " Premium on Shares," and is treated as a capital profit. Like all other capital profits, it is not regarded as a profit available for dividend, but is carried forward on the liabilities side of the Balance Sheet.

The Journal entry relating to the reissue of 5,000 shares by the Excel Co., Ltd., at a premium of 5s. per share would be as shown on page 105, marked "C."

It must not be thought that premiums on the issue

C.—JOURNAL ENTRY RECORDING REISSUE AT A PREMIUM

193..			£	s.	d.	£	s.	d.
May 10	Mr. A.B . . . . . *Dr.*		2,500	–	–			
	Forfeited Shares Account		3,750	–	–			
	To Issued Share Capital Account					5,000	–	–
	,, Premium on Shares Account					1,250	–	–
			£6,250	–	–	£6,250	–	–
	Being the reissue of 5,000 Forfeited Shares (15s. paid) to Mr. A.B at a premium of 5s. per Share. (Board Minute No.——, Dated——.)							

of shares arise only in connection with forfeited shares. It is quite legal for a company to issue its shares, at any time, at a premium. The circumstances and methods under which this is effected are explained fully in the next chapter.

SELF-EXAMINATION QUESTIONS. VIII

1. Explain the uses of First Call Account, Second Call Account, Final Call Account, Application and Allotment Account.

2. What accountancy procedure follows on the forfeiture of shares in a limited company?

3. The Jason Co., Ltd., has a nominal capital of £80,000 divided into 10,000 8 per cent Preference Shares of £4 each and 40,000 Ordinary Shares of £1 each. On 2nd January 8,000 Preference and 20,000 Ordinary Shares were applied for, and 5s. per share received. On 1st February these shares were allotted; 10s. per share being payable on allotment. £3,500 was received in respect of the Preference and £8,000 for Ordinary during February. On 1st March calls were made: £2 per Preference Share and 5s. per Ordinary Share. During March £13,000 was received from the Preference holders and £3,200 from the Ordinary shareholders. The transactions are to be posted to the Ledger. A statement is then to be prepared showing the capital position.

4. The Nominal Capital of the Richmond Co., Ltd., consists of 100,000 shares of £1 each. The whole of these shares were issued and were fully called up in four equal instalments of 5s. each. On 12th February, after due notice, the directors passed a resolution forfeiting the 1,000 shares held by Mr. W. A. Richardson, the final instalment due upon his holding not having been paid. On 1st May, the 1,000 shares referred to above were issued, as fully paid, to Captain Hayward, who paid £500 for them. Give the entries necessary to record these transactions in the Company's books.—(*London Chamber of Commerce.*)

CHAPTER IX

THE ISSUE OF SHARES AT A PREMIUM AND AT A DISCOUNT

THE issue of shares at a premium by a company is usually only possible when its shares are already quoted at a premium on one of the Stock Exchanges. This remark does not, of course, apply to private companies which also are able, from time to time, to obtain more than par for their shares.

Premiums on Shares.

In both cases the fixing of the premium to be asked of intending shareholders is carried out by the directors, who also decide whether the premium is to be paid with the application money, with one of the calls, or with the final payment. Whatever the decision the entries made by the secretary follow out the lines of the illustration already given.

EXAMPLE 1. The M. V. Co., Ltd., offers 100,000 of its shares, of a nominal value of £1, for subscription at the price of 25s. per share. The shares are to be paid for as follows—

10s. per share on application (including 5s. per share premium) (1st January).

5s. per share on allotment (15th January).

10s. per share one month later.

It is required to show the Ledger Accounts relating to the issue, assuming that excess subscriptions for 10,000 shares had to be returned. The present capital is £150,000. The Ledger Accounts are shown on pages 108 and 109.

EXAMPLE 2. The M. V. Co., Ltd., makes an issue of 100,000 shares on the same terms as those set out in

EXAMPLE 1. THE M.V. CO., LTD.

Dr. APPLICATION AND ALLOTMENT ACCOUNT *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Jan. 1	To Share Capital Account: 5s. per share on application and 5s. per Share on Allotment of 100,000 Shares	Jnl.	50,000	–	–	Jan. 1	By Cash received from Applicants for 110,000 Shares at 10s. per Share	C.B.	55,000	–	–
,, 1	,, Transfer to Premium on Shares Account: 5s. per Share on 100,000 Shares	Jnl.	25,000	–	–	,, 15	,, Cash received from Allottees in respect of 100,000 Shares at 5s. per Share	C.B.	25,000	–	–
,, 15	,, Cash returned to Applicants for 10,000 Shares not allotted	C.B.	5,000	–	–						
			£80,000	–	–				£80,000	–	–

Dr. FIRST AND FINAL CALL ACCOUNT *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Feb. 15	To Share Capital Account: 10s. call on 100,000 Shares	Jnl.	50,000	–	–	Feb. 15 to 20	By Cash received from Allottees: 10s. per Share on 100,000 Shares	C.B.	50,000	–	–
			£50,000	–	–				£50,000	–	–

EXAMPLE 1 (*contd.*). **THE M.V. CO., LTD.**

Dr. **PREMIUM ON SHARES ACCOUNT** *Cr.*

						193..			£	s.	d.
						Jan. 1	By Transfer from Application and Allotment Account: 5s. per Share premium on issue of 100,000 Shares . .	Jnl.	25,000	–	–

Dr. **ISSUED SHARE CAPITAL** *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Feb. 15	To Balance . . .	c/d	250,000	–	–	Jan. 1	By Balance at this date b/f		150,000	–	–
						,, 1	,, Issue of 100,000 Shares: 10s. per Share on Application and Allotment	Jnl.	50,000	–	–
						Feb. 15	,, Issue of 100,000 Shares: 10s. per Share on Final Call	Jnl.	50,000	–	–
			£250,000	–	–				£250,000	–	–
						193.. Feb. 15	By Balance . . .	b/d	250,000	–	–

Example 2. THE M.V. CO., LTD.

Dr. **APPLICATION AND ALLOTMENT ACCOUNT** *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Jan. 1	To Share Capital Account: 5s. per Share on Application and 5s. per Share on Allotment of 100,000 Shares	Jnl.	50,000	–	–	Jan. 1	By Cash received from Applicants for 110,000 Shares at 5s. per Share	C.B.	27,500	–	–
,, 15	,, Cash returned to Applicants for 10,000 Shares not allotted	C.B.	2,500	–	–	,, 15	,, Cash received from Allottees in respect of 100,000 Shares at 5s. per Share	C.B.	25,000	–	–
			£52,500	–	–				£52,500	–	–

Dr. **FIRST AND FINAL CALL ACCOUNT** *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Feb. 15	To Share Capital Account: 10s. Call on 100,000 Shares	Jnl.	50,000	–	–	Feb. 15	By Cash received from Allottees: 15s. per Share on 100,000 Shares	C.B.	75,000	–	–
,, 15	,, Transfer to Premium on Shares Account: 5s. per Share on 100,000 Shares	Jnl.	25,000	–	–						
			£75,000	–	–				£75,000	–	–

Dr. **PREMIUM ON SHARES ACCOUNT** *Cr.*

193..			£	s.	d.
Feb. 15	By Transfer from First and Final Call Account: 5s. per Share premium on issue of 100,000 Shares	Jnl.	25,000	–	–

Example 1 except that the premium is payable with the final call instead of with the application and allotment money. The accounts are shown on page 110.

Notes. (1) The Share Capital Account for Example 2 is not repeated as it is identical with that given for Example 1. (2) The corresponding entries in both examples should be compared, and the slight differences which occur when the premium is payable at the beginning and at the end of the issue should be carefully noted.

In practice, the issue of Shares is often made by an issuing house whose stipulations and conditions have to be observed. In nearly every case they insist on the payment of the premium with the application.

The Accounts of Different Classes of Share.

The Secretary may wonder why the treatment of different classes of share has not been introduced into the various illustrations given in this and the preceding chapter. The reason is that with the single exception of the issue of shares at a discount—which will be dealt with in the next paragraph—the classification of shares need not be allowed to obscure the points we have studied. The student should re-read the text until he has thoroughly grasped the uses of the Application Account, the Calls Accounts, and the Premium on Shares Account. For this purpose he need only apply the illustrations to companies having one class of share. This done, he has nothing further to learn on this subject, even though he may be called upon to deal with the Capital Accounts of companies having two, three, or even more classes of share. All he need do is to arrange his books so as to enable him to keep trace of the payments of calls on account of each class of share. This arrangement may be illustrated by means of the following example.

EXAMPLE. The Industria Co., Ltd., has the following authorized capital—

	£
500,000 6 per cent First Cumulative Preference Shares of £1 each . .	500,000
500,000 7 per cent Second Cumulative Preference Shares of £1 each . .	500,000
1,000,000 Ordinary Shares of £1 each . .	1,000,000
100,000 Deferred Shares of 1s. each . .	5,000
	£2,005,000

The directors decide to make an issue of each class of shares, and the secretary thereupon prepares the following schedule of the accounts he will be called upon to open—

A. *Issue of 6 per cent First Preference Shares*—	*Accounts to be Opened*
5s. payable on Application . } 5s. payable on Allotment . }	1st Preference Shares Application and Allotment Account.
10s. payable two months later .	1st Preference Shares, First and Final Call Account.

B. *Issue of 7 per cent Second Preference Shares*—	
6s. payable on Application, including 1s. per Share Premium }	2nd Preference Shares Application and Allotment A/c.
2s. 6d. payable on Allotment . }	Premium on Shares Account.
2s. 6d. payable one month later	2nd Preference Shares, 1st Call Account.
2s. 6d. payable two months later	2nd Preference Shares, 2nd Call Account.
7s. 6d. payable three months later	2nd Preference Shares, Final Call Account.

C. *Issue of Ordinary Shares*—	
10s. payable on Application . } 10s. payable on Allotment . }	Ordinary Shares Application and Allotment Account.

D. *Issue of Deferred Shares*—	
3d. payable on Application . } 3d. payable on Allotment . }	Deferred Shares, Application and Allotment Account.
3d. payable one month later .	Deferred Shares, First Call Account.
3d. payable two months later .	Deferred Shares, Second and Final Call Account.

In complicated issues such as the above, the secretary is recommended to open special Cash Books. These should be allotted to the various classes involved, e.g. "Ordinary Shares Issue Cash Book," "1st Preference Shares Issue Cash Book," etc. This facilitates the balancing of the cash receipts, the correct analysis of the application and call incomes. The use of separate Cash Books also tends to minimize the errors which creep in when cash has to be returned to unsuccessful applicants for certain classes of share. Columnar Cash Books may, of course, be adopted if desired.

Issue of Shares at a Discount.

Since the passing of the Companies Act, 1929, it has been legal to issue shares at a discount. There are, however, certain conditions attaching to the permission and these must be complied with strictly. Briefly, the rules are as under (Sect. 47)—

1. Shares issued at a discount must be of a class already issued.
2. The company must pass a special resolution on the matter.
3. The issue must be sanctioned by the Court.
4. At least one year must have elapsed since commencement of business.

In addition to the foregoing rules it is stipulated in Sect. 47 that any discount on shares issued shall be stated in every Balance Sheet until the whole amount is written off. This means that it is not enough to record only the debit in the Cash Book in respect of the cash paid in by allottees of shares issued at a discount. The secretary must enter in the Share Capital Account a credit for the full nominal value of the shares issued. The corresponding debits will be made to a Call Account and to a Discount on Shares Account.

EXAMPLE. The Excelsior Co., Ltd., decides to issue the balance of its share capital, viz. £100,000, at a

THE EXCELSIOR CO., LTD.

APPLICATION AND ALLOTMENT ACCOUNT

Dr. *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Jan. 1	To Issued Share Capital Account: 10s. per Share on 100,000 Shares .	Jnl.	50,000	–	–	Jan. 1 to 8	By Cash: 5s. per Share on Application and 5s. per Share on Allotment of 100,000 Shares . .	C.B.	50,000	–	–
			£50,000	–	–				£50,000	–	–

FIRST AND FINAL CALL ACCOUNT

Dr. *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Mar. 1	To Issued Share Capital Account: 5s. per Share on 100,000 Shares . .	Jnl.	25,000	–	–	Mar. 1	By Cash: 5s. per Share on 100,000 Shares . .	C.B.	25,000	–	–
			£25,000	–	–				£25,000	–	–

THE EXCELSIOR CO., LTD.

ISSUED SHARE CAPITAL ACCOUNT

Dr. *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Mar. 1	To Balance	c/d	250,000	–	–	Jan. 1	By Balance . . b/d		150,000	–	–
						,, 1	,, Application and Allotment Account: 10s. per Share on 100,000 Shares .	Jnl.	50,000	–	–
						Mar. 1	,, First and Final Call Account: 5s. per Share on 100,000 Shares . .	Jnl.	25,000	–	–
						,, 1	,, Discount on Shares Account: 5s. per Share on 100,000 Shares . .	Jnl.	25,000	–	–
			£250,000	–	–				£250,000	–	–
						193..					
						Mar. 1	By Balance . . .	b/d	250,000	–	–

THE EXCELSIOR CO., LTD.

DISCOUNT ON SHARES ACCOUNT

Dr. *Cr.*

193..			£	s.	d.					
Mar. 1	To Discount on 100,000 Shares at 5s. per Share . .	Jnl.	25,000	–	–					

(Extract from) **BALANCE SHEET AS AT 1st MARCH, 193 . .**

Liabilities	£	s.	d.	Assets	£	s.	d.
Authorized and Issued Share Capital .	250,000	–	–	Discount on Shares Account . .	25,000	–	–

discount of 5s. per share, thus completing the issue of its authorized capital of £250,000. On application, 5s. per share is payable, on allotment 5s., and on first and final call, 5s. The final call is payable two months after Allotment. For illustration see pages 114 to 116.

The Journal entries on which the above example is based should include full narrations, incorporating references to the date of the special resolution, the sanction of the Court, and to the directors' board minute.

Writing Off Discount on Shares.

A prudent board of directors loses no time in writing off discount on shares. There is no recognized rate at which the writing-off should be effected, and provision is made according to circumstances. The " amortization " is not treated as a trading expense chargeable against profits, but as an appropriation. It is therefore debited to Appropriation Account, the corresponding credit being made to " Discount on Shares," thus reducing the amount standing to the debit of that account.

Commission on Shares.

In addition to allowing discount on shares, which has only recently been legalized, it is possible for a company to allow commission on its shares. The regulations governing this matter are contained in Sect. 43 of the Companies Act, 1929, which provides *inter alia* that—

1. The payment must be authorized by the Articles.
2. The amount paid must not exceed 10 per cent of the issue price.

It is laid down in Sect. 44 that commission on shares shall, like discount, be shown separately in the Balance Sheet until it has been written off.

Example. The Abbey Co., Ltd., makes an issue of 100,000 shares of £1 each (its authorized capital), payable 10s. on application and 10s. on allotment. The

THE ABBEY CO., LTD.

APPLICATION AND ALLOTMENT ACCOUNT

Dr. *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Jan. 1	To Issued Share Capital Account: 10s. per Share on Application and 10s. per Share on Allotment	Jnl.	100,000	–	–	Jan. 1 to 10	By Cash received from Applicants . . .	C.B.	100,000	–	–
			£100,000	–	–				£100,000	–	–

ISSUED SHARE CAPITAL ACCOUNT

Dr. *Cr.*

						193..			£	s.	d.
						Jan. 1	By Application and Allotment Account . .	Jnl.	100,000	–	–

THE ABBEY CO., LTD.

COMMISSION ON SHARES ACCOUNT

Dr. *Cr.*

193..			£	s.	d.						
Jan. 1	To Commission of 2s. per Share on 100,000 Shares allowed to Morgan & Co. . .	Jnl.	20,000	–	–						

MORGAN & CO.

Dr. *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Jan. 30	To Cash	C.B.	20,000	–	–	Jan. 1	By Commission of 2s. per Share on 100,000 Shares placed by them	Jnl.	20,000	–	–
			£20,000	–	–				£20,000	–	–

THE ABBEY CO., LTD.

(EXTRACT FROM) BALANCE SHEET AS AT 31st JANUARY, 193..

ASSETS	£	s.	d.	LIABILITIES	£	s.	d.
Authorized and Issued Capital . .	100,000	–	–	Commission on Shares Account . .	20,000	–	–

shares are placed by Morgan & Co., a firm of stock-brokers who are paid a commission of 2s. per share. See pages 118 and 119.

SELF-EXAMINATION QUESTIONS. IX

1. The Chilworth Motor Co., Ltd., was registered in 19—. The Nominal Capital of the Company consists of 200,000 6 per cent Preference Shares of £1 each, and 200,000 Ordinary Shares of £1 each. During the year the whole of the Preference Shares and 100,000 of the Ordinary Shares were issued to the public and fully paid up, with the exception of £100 calls in arrear on the Ordinary Shares.

The company was very successful and, during the year offered the balance of the Ordinary Shares to the public at a premium of 10s. per share. All the issue was taken up and duly allotted, payable, as to 12s. 6d. per share on application (including the premium), and 7s. 6d. per share one month after allotment. No further calls were made during the year.

Set out the Capital of the Company as it would appear in the Balance Sheet as on 31st December.—(*London Chamber of Commerce.*)

2. Explain the procedure to be followed in issuing shares at a discount.

3. What is Commission on shares? How must it be treated in the accounts of a company?

4. The Directors of the Old Time Spinning Co. decide to replace entirely their Plant, which is now out of date. Having advertised for tenders for the new machinery they require, they accept that sent in by Messrs. A B & Co., amounting to £8,850.

The old Machinery and Plant Account stood in the books of the Company at £5,400. There was also a Depreciation Fund in the books, the accumulated credit balance of which amounted to £1,050. Some of the materials composing the old machinery were found to be in good condition, and Messrs. A B & Co. agreed to take over shafting, etc., valued at £550, for use again; whilst the remainder was put up to auction and realized £1,200 (net).

Make the entries necessary to record these transactions in the books of the Old Time Spinning Co., and state how you would deal with the balance of the old "Machinery and Plant Account."—(*London Chamber of Commerce.*)

5. A company which has three classes of share in its authorized capital decides to make an issue of all three classes. There are to be two calls following the application allotment at intervals of one month each and a final call three months later. You are requested to advise the secretary as to the accounts he should open. The classes of share are: "7 per cent Preference," "Ordinary," and "Deferred."

CHAPTER X

REDEEMABLE PREFERENCE SHARES

A COMPANY may issue preference shares which "are, or at the option of the company are liable, to be redeemed." Certain conditions which are set out fully in Sect. 46 of the Companies Act, 1929, have to be complied with. These conditions include the following:

1. The redemption may either be made out of the cash representing profits available for dividend or the necessary funds may be provided out of the proceeds of a new issue of shares made for the purpose.

2. Only fully-paid shares may be redeemed.

3. When the shares are redeemed out of profits a corresponding amount must be transferred to a "Capital Redemption Reserve Fund."

4. The Balance Sheet must specify what part of the issued capital consists of redeemable shares, and must state the latest date by which such shares are liable to be redeemed.

EXAMPLE. The Rayon d'Or Co., which was incorporated after the date on which the Companies Act, 1929, came into force, has an authorized and issued capital of £500,000, half of which is in ordinary shares and half in 6 per cent Redeemable Preference Shares. These shares are redeemable at the option of the company not later than January, 1940. In January, 1932, the company decides to redeem £50,000 of the shares out of its available profits of £100,000. See pages 122, 123 and 124.

Redemption at a Premium.

Subsec. 1 (*d*) of Sect. 46 of the Companies Act, 1929, provides that if a premium is payable on the redemption of preference shares such premium shall be provided

THE RAYON D'OR CO., LTD.—REDEMPTION AT PAR 6 PER CENT REDEEMABLE PREFERENCE SHARE ACCOUNT

Dr. *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Jan. 1 to 31	To Cash paid to Holders of 50,000 Shares redeemed at par	C.B.	50,000	–	–	Jan. 1	By Balance at this date	b/f	250,000	–	–
,, 31	,, Balance	c/d	200,000	–	–						
			£250,000	–	–				£250,000	–	–
						1932 Feb. 1	By Balance	b/d	200,000	–	–

CAPITAL REDEMPTION RESERVE FUND

Dr. *Cr.*

1932			£	s.	d.
Jan. 1	By Transfer of Profits from Profit and Loss Appropriation Account equivalent to the amount applied to the redemption of 50,000 Shares	Jnl.	50,000	–	–

THE RAYON D'OR CO., LTD.—REDEMPTION AT PAR (*contd.*)

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Jan. 1	To Transfer to Capital Redemption Reserve Fund of a sum equivalent to the amount applied in Redemption of 50,000 Preference Shares.	Jnl.	50,000	–	–	Jan. 1	By Balance at this date	b/f	100,000	–	–
,, 1	,, Balance	c/d	50,000	–	–						
			£100,000	–	–				£100,000	–	–
						1932 Feb. 1	By Balance	b/d	50,000	–	–

THE RAYON D'OR CO., LTD.

(EXTRACT FROM) BALANCE SHEET AS AT 31st JANUARY, 1932

LIABILITIES	£	£	ASSETS		
AUTHORIZED CAPITAL—					
250,000 6 per cent Redeemable Preference Shares of £1 each	250,000				
250,000 Ordinary Shares of £1 each	250,000				
		500,000			
ISSUED CAPITAL—					
200,000 6 per cent Redeemable Preference Shares of £1 each	200,000				
250,000 Ordinary Shares of £1 each	250,000				
		450,000			
Capital Redemption Reserve Fund		50,000			
Profit and Loss Appropriation Account		50,000			

NOTE. *The reader will notice that the Capital Redemption Reserve is called a "Fund." This is to comply with the wording of the Companies Act, 1929, which specifies the word "Fund." This ruling, which conflicts with accountancy practice, will possibly be amended in the future.*

for out of profits. If then the preference shares of the Rayon d'Or Co., Ltd., had been repayable at 25s. per share it would have been necessary to transfer £12,500 from Appropriation Account in respect of the premium.

The steps to be taken in such a case would be—

1. Open a " Preference Capital Redemption Account."

2. Debit " 6 per cent Redeemable Preference Share Capital " with £50,000, and credit a similar amount to " Preference Capital Redemption Account."

3. Debit Profit and Loss Appropriation Account with £50,000 in respect of the nominal value of the shares to be redeemed, and credit " Capital Redemption Reserve Fund."

4. Transfer £12,500 in respect of the premium from Appropriation Account to " Preference Capital Redemption Account."

5. Pay each shareholder 25s. per share, crediting the Cash Book and debiting " Preference Capital Redemption Account " with £62,500.

The Ledger Accounts are illustrated on pages 126 and 127.

Alternative Method. There is an alternative method of dealing with the redemption of preference shares at a premium. It is based on the literal reading of Subsec. 1 (*c*) of Sect. 46, which says that the Capital Redemption Reserve Fund shall consist of " a sum equal to the amount applied in redeeming the shares." Under this alternative method the transfer to Capital Redemption Reserve Fund, in the example just considered, would be £62,500—this being the sum applied to the redemption. The premium is then written off against the Reserve Fund, the ultimate result being the same as that obtained in our illustration.

Whilst there is something to be said for this interpretation it is open to the objection that the Section does not seem to countenance any reduction of the

THE RAYON D'OR CO., LTD.—REDEMPTION AT A PREMIUM

6 PER CENT REDEEMABLE PREFERENCE SHARE CAPITAL ACCOUNT

Dr. *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Jan. 1	To Transfer to Preference Capital Redemption Account	Jnl.	50,000	–	–	Jan. 1	By Balance at this date	b/f	250,000	–	–
,, 1	,, Balance	c/d	200,000	–	–						
			£250,000	–	–				£250,000	–	–
						1932 Jan. 1	By Balance	b/d	200,000	–	–

PREFERENCE CAPITAL REDEMPTION ACCOUNT

Dr. *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Jan. 1 to 31	To Cash paid to Sundry Shareholders in respect of 50,000 Shares at 25s. per Share	C.B.	62,500	–	–	Jan. 1	By Transfer from 6 per cent Redeemable Preference Share Capital Account	Jnl.	50,000	–	–
						,, 1	,, Transfer from Profit and Loss Appropriation Account	Jnl.	12,500	–	–
			£62,500	–	–				£62,500	–	–

THE RAYON D'OR CO., LTD.—REDEMPTION AT A PREMIUM *(contd.)*

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Jan. 1	To Transfer to Capital Redemption Reserve Fund	Jnl.	50,000	–	–	Jan. 1	By Balance at this date .	b/d	100,000	–	–
,, 1	,, Transfer to Preference Capital Redemption Account . . .	Jnl.	12,500	–	–						
,, 1	,, Balance . . .	c/d	37,500	–	–						
			£100,000	–	–				£100,000	–	–

CAPITAL REDEMPTION RESERVE FUND

Dr. *Cr.*

1932			£	s.	d.	1932			£	s.	d.
						Jan. 1	By Transfer of Profits from Profit and Loss Appropriation Account .	Jnl.	50,000	–	–

Reserve Fund once it is established, except under the particular circumstances of subsection 5. The student reader is, therefore, advised not to adopt the alternative method.

Redemption Out of Fresh Issues.

It will be noticed that whilst the Issued Preference Capital is reduced by a redemption, the Authorized Capital remains unchanged. This is correct for Subsec. 4 of Sect. 46 of the Companies Act, 1929, provides that redeemed preference shares may be reissued and no additional payment of stamp duty need be made. There is, however, a provision to the effect that if an issue is made of new shares, intended to replace an issue *about* to be redeemed, then the actual redemption must follow within one month. If a longer delay takes place additional stamp duty is payable.

The secretary should experience no difficulty in recording the redemption of preference shares out of the proceeds of a new issue. He is advised to dissociate the two points from one another entirely; the fact that the cash to be paid out is receivable from shareholders has no actual connection with the redemption. They are only associated because the company would presumably not have the necessary cash available were it not for the new issue. The procedure, therefore, follows these lines—

1. Debit Share Capital with the nominal value of the shares to be redeemed and credit—

   (*a*) Cash, if shares are redeemable at par.

   (*b*) Redemption Account if at a premium.

2. Debit Profit and Loss Appropriation Account and credit Redemption Account with premium, if any.

3. Credit Cash Book with payments made to shareholders and debit—

   (*a*) Share Capital Account, if shares are redeemable at par.

(*b*) Redemption Account, if at a premium.

4. Debit Cash Book in respect of subscriptions paid in by applicants for the new issue, and credit Share Capital Account, either direct or via Call Accounts.

It should be noted carefully, that when the cash necessary for the redemption is furnished by a new issue there is no transfer to Capital Redemption Reserve Fund. In such a case the only amount to be provided for out of profits is the premium payable on redemption of the old shares, if any.

Distribution of Capital Redemption Reserve Fund.

Subsec. 5 of Sect. 46 of the Companies Act, 1929, permits the distribution of the Redemption Fund by way of a bonus issue of shares. As we have not yet studied bonus issues, however, this point is deferred to a later chapter.

Redemption at a Discount.

The Companies Act, 1929, is silent as to the redemption of preference shares at a discount, and the secretary has therefore no statutory guidance on procedure. He merely knows that the practice is not contrary to law. A simple method of recording redemption at a discount is given below—

1. Debit "Redeemable Preference Share Capital Account" with the full nominal value of the shares to be redeemed, and credit "Preference Capital Redemption Account."

2. Debit "Profit and Loss Appropriation Account," and credit "Capital Redemption Reserve Fund" with the nominal value of the shares redeemed.

3. Credit Cash in respect of the payments to the shareholders, and debit "Preference Capital Redemption Account."

THE RAYON D'OR CO., LTD.—REDEMPTION AT A DISCOUNT

6% REDEEMABLE PREFERENCE SHARE CAPITAL ACCOUNT

Dr. *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Jan. 1	To Transfer to Preference Capital Redemption Account	Jnl.	50,000	–	–	Jan. 1	By Balance at this date	b/d	250,000	–	–
,, 1	,, Balance	c/d	200,000	–	–						
			£250,000	–	–				£250,000	–	–
						1932 Jan. 1	By Balance	b/d	200,000	–	–

PREFERENCE CAPITAL REDEMPTION ACCOUNT

Dr. *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Jan. 1 to 31	To Cash paid to Sundry Shareholders in respect of 50,000 Shares: 15s. per Share	C.B.	37,500	–	–	Jan. 1	By Transfer from 6 per cent Redeemable Preference Share Capital Account	Jnl.	50,000	–	–
,, 31	,, Transfer to Capital Reserve Account	Jnl.	12,500	–	–						
			£50,000	–	–				£50,000	–	–

4. Transfer the credit balance remaining on "Preference Capital Redemption Account" to a "Capital Reserve Account."

For the purposes of illustration we will again take the case of the Rayon d'Or Co., Ltd. In this instance it is assumed that the 50,000 preference shares are redeemed at a discount of 5s. per share. See pages 130 and 132.

Alternative Methods. As in the case of redemption at a premium so also in the case of redemption at a discount, there are alternative methods. The first alternative is based on the exact wording of the Act. It consists of the transfer to Capital Redemption Reserve Fund of an amount equal to the cash paid out and not to the nominal value of the shares. In the case we have just considered the transfer would be £37,500 and not £50,000. Provided the profit represented by the discount (£12,500) is duly carried to a Capital Reserve Account, this alternative method could be adopted, for the reduction of the Share Capital by £50,000 would be exactly counterbalanced by the Capital Redemption Reserve Fund (£37,500) and the Capital Reserve Account (£12,500). In fact, this alternative method is the more correct in this particular respect, for under the first scheme a total amount of £62,500 is carried forward on capital accounts as against the former amount of £50,000 represented by Share Capital. The secretary must note, however, that there is no obligation to transfer the profit on redemption (£12,500) to Capital Reserve Account. Should his directors decide to treat the profit as divisible, then the adoption of the alternative method would be tantamount to a reduction of capital.

Second Alternative. There is a second alternative method which satisfies the points raised on both schemes illustrated above. This alternative consists of the transfer of the cash applied in the redemption to

THE RAYON D'OR CO., LTD.—REDEMPTION AT A DISCOUNT (*contd.*)

CAPITAL RESERVE ACCOUNT

Dr. *Cr.*

						1932			£	s.	d.
						Jan. 31	By Transfer from Preference Capital Redemption Account . . .	Jnl.	12,500	–	–

CAPITAL REDEMPTION RESERVE FUND

Dr. *Cr.*

						1932			£	s.	d.
						Jan. 31	By Transfer from Profit and Loss Appropriation Account in respect of 50,000 Shares of £1 each redeemed . .	Jnl.	50,000	–	–

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Jan. 1	To Transfer to Capital Redemption Reserve Fund	Jnl.	50,000	–	–	Jan. 1	By Balance at this date .	b/d	100,000	–	–
,, 1	,, Balance . . .	c/d	50,000	–	–						
			£100,000	–	–				£100,000	–	–
						1932					
						Jan. 1	By Balance . . .	b/d	50,000	–	–

" Capital Redemption Reserve Fund," and also of the transfer to the same account of the profit represented by the discount. In the case of the Rayon d'Or Co. the result would be that, whilst a debit of £37,500 only would be made to Appropriation Account, there would be no danger of a reduction of capital. The diminution of the Share Capital Account by £50,000 would be offset by an exactly similar balance on Capital Redemption Reserve Fund, which as we know cannot be used for revenue purposes.

In deciding upon the respective merits of the three methods in practice, an onerous duty devolves on the secretary. If, however, he consistently counsels the treatment of the discount as a capital profit, he cannot fail to offer his directors sound advice.

SELF-EXAMINATION QUESTIONS. X

1. Set out, briefly, the procedure and effect of the redemption of Redeemable Preference Shares.

2. The Retour Co., Ltd., has, as part of its Authorized and Issued Capital £500,000 in 8 per cent Redeemable Preference Shares of £1 each. These shares are redeemable at the option of the company and the option is duly exercised on 31st December, 1935. The credit balance on Profit and Loss Account is £750,000. Set out the entries in the Ledger arising from the redemption.

3. The Jason Co., Ltd., has issued 250,000 7½ per cent Redeemable Preference Shares of £1 each. It decides to redeem these shares on 30th June, 1935, out of the proceeds of a new issue to be made on 15th June of the same year. The new shares are issued on payment of 10s. on application (15th June) and 10s. on allotment (25th June). The Company has a credit balance of £150,000 on Profit and Loss Account. It is required to show the entries relating to this redemption.

4. Set out the procedure to be followed by the Secretary on the redemption of shares at a premium, quoting the authority of the Companies Act, 1929, for the steps taken.

5. The Gambia Co., Ltd., decides to redeem 40,000 of its 5 per cent £1 Preference Shares at a discount of 2s. 6d. per share, the holders of such shares having expressed their agreement to such redemption. The credit balance on the company's Profit and Loss Account is £50,000. Set out the ledger entries recording this redemption.

CHAPTER XI

CAPITALIZATION OF PROFITS AND RESERVES

In Chapter V we read that the shareholders' capital remained in the Balance Sheet at a constant figure, unaffected by annual profits or losses. It is now necessary to qualify the statement to a certain extent and to examine the effect of large accumulations of profit or of continued heavy losses.

In the case of sole traders and partnerships we have seen that each year's losses are deducted from the Capital Account or Capital Accounts, and that the profits are similarly added. The result is that the Capital Account correctly represents the net assets of the business concerned.

In the case of a company it is, of course, impossible to add profits or to deduct losses from the issued capital. To do so would entail annual adjustments to the shareholding of each of the members. Accumulated profits, less any dividends paid, are therefore carried forward on the Liabilities side of the Balance Sheet, either as a balance on profit and Loss Appropriation Account, or as a balance on a Reserve Account. Accumulated losses are carried forward on the Assets side—still described as " Profit and Loss Account "—and constitute a " fictitious asset." This procedure can only continue for a limited period, and ultimately the board of directors proceed on one or other of the lines dealt with in this chapter (" Capitalization of Profits ") or in the following chapter (" Capital Reduction ").

Capitalization of Profits.

When a company has accumulated a larger credit balance on its General Reserve or on its Appropriation

Account, than is warranted, it may decide to capitalize a portion and to distribute it in the form of shares among its members. To grasp what this means it is first necessary to understand how such a position can arise. The student may ask, Why has the company accumulated such large reserves of undistributed profit instead of dividing them among the members in cash? The answer is to be found in the examples we studied in Chapter VII. There we saw that whilst a company may have made a profit of £5,500, it could only distribute the limited sum of £2,500, that being the amount of free cash available for dividend. The balance of £3,000 was transferred in the example given to a General Reserve Account. This is exactly what occurs year after year with successful and expanding businesses. The increased trade they do, whilst resulting in increased profits, tends to lock up more and more capital every year. Their reserves increase at a corresponding rate until at last the Issued Capital has to be brought more into accord with the actual value of the net assets.

Accountancy Procedure.

The accountancy procedure on a capitalization of reserves is in no way involved. All that is necessary is—

1. Transfer from the Reserve Account or accounts a sum sufficient to cover the nominal value of the bonus shares to be issued, and credit the amount to "Bonus Account."

2. Debit "Bonus Account," and credit "Issued Share Capital Account" with the nominal value of the shares issued.

The following illustration shows the effect of the two foregoing simple entries.

EXAMPLE. The Alpha Co., Ltd., which has an authorized capital of £150,000 in ordinary shares, decides on 1st December, 1930, to issue 50,000 shares to its present shareholders by way of bonus in the

THE ALPHA CO., LTD.

JOURNAL ENTRIES

1930			£	s.	d.	£	s.	d.
Dec. 1	General Reserve Account	*Dr.*	50,000	–	–			
	To Bonus Account					50,000	–	–
	Being the transfer of amount to be distributed as bonus in accordance with Board minute No..... dated.....							
Dec. 1	Bonus Account	*Dr.*	50,000	–	–			
	To Issued Capital Account					50,000	–	–
	Being the issue of 1 share for every 2 shares held by shareholders in accordance with Board minute No..... dated.....							

proportion of one for every two held at present. The bonus is to be effected out of General Reserve, which stands at £74,200 (see page 136).

The effect of the Balance Sheet of the Alpha Co., Ltd., before and after the bonus issue is as follows—

Before Capitalization of Reserves				*After Capitalization of Reserves*			
Authorized Capital				Authorized Capital			
	£150,000	–	–		£150,000	–	–
	£	s.	d.		£	s.	d.
Issued Capital .	100,000	–	–	Issued Capital .	150,000	–	–
General Reserve Account .	74,200	–	–	General Reserve Account .	24,200	–	–

Use of "Bonus Account."

It may be asked why it is necessary to employ a "Bonus" Account in view of the fact that it is closed almost as soon as it is opened. The answer is that a full record of the issue must be kept in the books, showing fully the authority for the declaration of the bonus. Occasionally shares are issued on which a part of the nominal amount is treated as a bonus, the balance being contributable in cash by the shareholders to whom they are issued. Such partial bonuses serve to emphasize the importance of opening a "Bonus Account," and thus keeping a permanent record of the issues made.

Illustration of a Partial Bonus.

The Alpha Co.—in the example above—decides to distribute 50,000 shares among the shareholders, provided they contribute at the rate of 5s. per share. In this case the bonus of 15s. per share, amounting to £37,500, must be transferred from General Reserve, whilst the £12,500 contributed by the shareholders will appear as a receipt in the Cash Book. The cash may be posted from the Cash Book to one of several accounts,

THE ALPHA CO., LTD.—PARTIAL BONUS ISSUE

			£	s.	d.	£	s.	d.
1.	General Reserve Account	*Dr.*	37,500	–	–			
	To Bonus Account					37,500	–	–
	Being transfer of reserves equal to 15s. per share on 50,000 shares to be issued to shareholders on the terms and conditions laid down in Board minute dated..... and in circular to shareholders dated.....							
2.	Bonus Account	*Dr.*	37,500	–	–			
	To Sundry Shareholders Account					37,500	–	–
	Transfer of bonus of 15s. per share on 50,000 shares in accordance with terms of Board minute referred to above.							
3.	Cash Account	*Dr.*	12,500	–	–			
	To Sundry Shareholders Account					12,500	–	–
	For receipts of 5s. per share in respect of 50,000 shares issued 15s. paid in accordance with Board minute referred to above.							
	(*Note.* This step, though given in the form of a Journal entry, would actually pass through the Cash Book.)							
4.	Sundry Shareholders Account	*Dr.*	50,000	–	–			
	To Issued Share Capital Account					50,000	–	–
	For increase of issued share capital—50,000 shares issued 15s. paid and 5s. per share payable by shareholders in accordance with Board minute referred to above.							

e.g. "Sundry Shareholders' Account," "Final Call Account," etc., according to the circumstances of the case and the number of instalments involved.

The ultimate increase to Share Capital Account can be traced through the Journal entries as shown on page 138.

Capitalization of Other Reserves.

In addition to General Reserves and accumulated profits on Appropriation Account, there are other reserves which companies may, and occasionally do, capitalize. A company may have set aside large sums to a Contingency Account to meet some heavy liability of an unascertained amount which fails to materialize. Again, it may find it possible to sell one or more of its assets, for which it has no further use, at a figure greatly in excess of book values. In both cases a free reserve, which could be capitalized, would appear in the books. In the first case the Contingency Account would already be contained on the Liabilities side of the Balance Sheet. After the passing of the necessary resolutions it would be necessary merely to change the name of the account. The secretary would then proceed to pass it through the Bonus Account to Share Capital Account as shown above. In the second case the cash received for the surplus assets would be debited in the Cash Book in the ordinary way, and then posted to the credit of each Asset Account concerned. These latter accounts would then show credit balances which would be transferred, preferably via the Journal, to Capital Reserve Account. The Asset Accounts themselves would disappear from the Balance Sheet, of course, but the Cash at Bank would be increased by the amount of the book value of the assets sold plus the realized profit. The increase in the Balance Sheet total of the assets would be balanced by the inclusion of the Capital Reserve Account on the Liabilities side.

The distribution of the capital reserve by way of bonus issue in such a case as the foregoing then follows exactly the same course as that given in the previous example.

Secret Reserves.

Lastly, we have to consider a matter which falls into its natural sequence at this point. In addition to contingency reserves created to meet possible commitments, many companies make it a practice to set aside large sums of profit secretly. We are not concerned, in this present volume, with the arguments for or against this practice. We have only to deal with the methods of recording them. This duty falls on the secretary of practically every successful company, sooner or later.

The object of creating secret reserves is to furnish a final line of defence in the process of strengthening a company's financial position. It follows, therefore, that directors rarely commence to build up secret reserves until a company's General and other Reserve Accounts have reached a considerable figure. These reserves, which we will term " open " reserves, could, of course, be augmented to any amount. But to do so to an unreasonable extent entails the certainty of criticism from the shareholders who press for a distribution. It is at this point, generally speaking, that directors commence to create secret reserves, the existence of which is kept from the knowledge of the shareholders.

Methods of Creating Secret Reserves.

The principal methods by which secret reserves are created are—

(*a*) Deductions from Assets Side of Balance Sheet.

1. By the excessive depreciation of plant, machinery, and similar fixed assets.

2. By the sale of superfluous assets at enhanced prices. The credit balance representing the profit made is deducted from the balance of a composite asset figure remaining in the Balance Sheet.

(*b*) Increases on Liabilities Side of Balance Sheet.

1. The inclusion among "Sundry Creditors" or a similar account, of excessive reserves for contingencies or remote liabilities; corresponding charges are made in the Profit and Loss Account.

2. The inclusion of profit arising on the sale of assets in a composite liability figure. This is an alternative to method (*a*) 2 above.

The effect of the Companies Act, 1929, on secret reserves will be considered in a later chapter when dealing with the secretary's duties under Sec. 123.

Capitalization of Secret Reserves.

It will be appreciated from the foregoing that secret reserves may arise from Capital Profits (e.g. Sale of Assets) or from Revenue Profits (e.g. the reduction of trading profits by excessive depreciation).

In both cases they may have been recorded in the books or they may have been suppressed altogether. If they represent revenue profits and have been retained on the books, then it is possible to transfer them from the account on which they have been carried, to one or other of the following—

(*a*) Profit and Loss Account.
(*b*) General Reserve Account.
(*c*) Capital Reserve Account.

If the secret reserves have been deleted from the books, e.g. by excessive depreciation or by the application of capital profits on sales of assets to the reduction

of Asset Accounts, then it is no easy task to restore them. The usual method is to have a revaluation of the fixed assets carried out by an independent firm of valuers. If the revaluation shows an excess over book values, the Asset Accounts are written up accordingly and the excess is credited to a Reserve Account on the Liabilities side of the Balance Sheet. As soon as this has been effected then a capitalization of the reserve may take place. The " Reserve Account," " General Reserve," or " Capital Reserve "—as the case may be—is transferred to the credit of Bonus Account as usual, and the further appropriate transfer is then made to Share Capital Account.

An illustration of the capitalization of a secret reserve is incorporated in the example of the Thespian Co., Ltd., used in the next paragraph which deals with " Bonuses Applied to Calls."

Bonus Applied to Calls.

From time to time companies apply portions of their reserves in making the partly-paid shares held by the shareholders, fully paid. The secretary then uses the Bonus Account to close the Call Account. The following example which explains the process, also includes an illustration of the capitalization of a secret reserve to which reference was made in the preceding paragraph.

EXAMPLE. The Thespian Co., Ltd., has an authorized and issued capital of £500,000, but each share is only 16s. paid. Its principal asset, Plant and Machinery, has been depreciated excessively in the past, and the profits arising on the sale of certain items have also been used to write the asset down. A revaluation shows that £174,000 could be added to the book figure. The directors decide to bring the Plant and Machinery up to the proper value, and to declare out of the excess a bonus sufficient to make the company's capital fully paid (see page 143).

THE THESPIAN CO., LTD.
JOURNAL

Date			£	s.	d.	£	s.	d.
Date	Plant and Machinery . . . . . *Dr.*		174,000	–	–			
	To Capital Reserve Account					174,000	–	–
	Amount added to this asset to bring it up to the valuation placed upon it by Messrs. Blank.							
Date	Capital Reserve Account . . . . . *Dr.*		100,000	–	–			
	To Bonus Account					100,000	–	–
	Transfer of amount to Bonus Account equivalent to 5s. per share on the company's issued capital, in accordance with Board minute dated.....							
Date	Final Call Account . . . . . *Dr.*		100,000	–	–			
	To Share Capital Account					100,000	–	–
	For final call of 5s. per share made this day.							
Date	Bonus Account . . . . . *Dr.*		100,000	–	–			
	To Final Call Account					100,000	–	–
	Amount transferred in satisfaction of Final Call Account in accordance with Board minute No..... dated.....							

THE CORONET CO., LTD.

Cr. 6% REDEEMABLE PREFERENCE SHARES CAPITAL ACCOUNT *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Jan. 1	To Cash paid to Shareholders on redemption of 50,000 shares at par	C.B.	50,000	–	–	Jan. 1	By Balance at this date .	b/d	250,000	–	–
,, 1	,, Balance . . .	c/d	200,000	–	–						
			£250,000	–	–				£250,000	–	–
						Jan. 1	By Balance . . .	b/d	200,000	–	–
						June 30	,, Cash received in respect of 50,000 shares issued this day . . .	C.B.	50,000	–	–
									£250,000	–	–

Dr. CAPITAL REDEMPTION RESERVE FUND *Cr.*

193..			£	s.	d.	193..			£	s.	d.
June 30	To Transfer to Bonus A/c .		50,000	–	–	Jan. 1	By Transfer from Appropriation A/c on redemption of 50,000 Redeemable Preference Shares . .	Jnl.	50,000	–	–
			£50,000	–	–				£50,000	–	–

THE CORONET CO., LTD.

ORDINARY SHARE CAPITAL ACCOUNT

Dr. *Cr.*

					193..			£	s. d.
					Jan. 1	By Balance at this date .	b/d	200,000	– –
					June 30	,, Issue of 50,000 shares, fully paid, by way of bonus . . .	Jnl.	50,000	– –
								£250,000	– –

BONUS ACCOUNT

Dr. *Cr.*

193..			£	s.	d.	193..			£	s.	d.
	To Distribution of Bonus in form of fully paid Ordinary Shares . . .	Jnl.	50,000	–	–	June 30	By Transfer from Capital Redemption Reserve Fund	Jnl.	50,000	–	–
			£50,000	–	–				£50,000	–	–

Redeemable Shares and Bonus Issues.

It will be recalled that when we studied the redemption of Redeemable Preference Shares, we found that it was necessary to make a transfer to " Capital Redemption Reserve Fund." This " Fund " has to be carried forward in the Balance Sheet, representing—as it does—profits which have been utilized and are no longer available for dividends.

At this point we must consider subsection (5) of the section in the Companies Act, 1929, which deals with redeemable shares. This subsection provides that if the redeemed shares are reissued at a later date, then the Redemption Reserve Fund may forthwith be capitalized. This capitalization takes the form of an issue to the shareholders of previously unissued shares as fully paid shares.

EXAMPLE. The Coronet Co., Ltd., has an authorized capital of £500,000, half of which is in 6 per cent redeemable preference shares. The issued capital consists of £200,000 in preference shares and £200,000 in ordinary shares. The company has redeemed 50,000 of the preference shares and now, six months later, decides to issue 50,000 similar shares for cash. The directors then decide to capitalize the Capital Redemption Reserve Fund and to issue 50,000 fully paid ordinary shares by way of bonus in the proportion of one share for every four held (see pages 144 and 145.)

SELF-EXAMINATION QUESTIONS. XI

1. How does the necessity for the capitalization of profits arise? Set out your answer briefly and include the results of such a procedure.
2. What is the use of a " Bonus Account " in the process of capitalization of profits and reserves?
3. What are Secret Reserves? How are they created and how may they be capitalized?
4. How may bonuses be applied in satisfaction of Calls? Set out the steps to be followed in this connection with a *pro forma* example.

5. Set out the procedure for the distribution by way of bonus of the "Capital Redemption Reserve Fund" arising on the redemption of a company's Preference Shares.

6. The Zebra Co., Ltd., has a credit balance on Profit and Loss Account of £650,000. Its Ordinary Shares (500,000 of £1 each) are 15s. paid and its 7 per cent Preferred Shares (1,000,000) are 17s. 6d. paid. It decides to declare a bonus equivalent to the unpaid capital and, after making the appropriate calls, apply the bonus in payment thereof. Set out the ledger accounts recording such a bonus.

CHAPTER XII

REDUCTION OF CAPITAL

THE method of dealing with accumulated losses, to which we referred briefly in Chapter XI, is the reduction of capital to an amount equal to the depleted net values of the assets. This process is governed by Sect. 55 of the Companies Act, 1929, the terms of which must be closely followed.

The two principal cases in which a capital reduction scheme is used to deal with losses are—

1. When the deficiency is represented by an accumulated debit balance on Profit and Loss Account. In this case the capital reduction merely wipes off the loss from Appropriation Account.

2. When the losses are reflected in the form of assets carried in the Balance Sheet at inflated values. This state of affairs may, or may not, be accompanied by a debit balance on Appropriation Account which also requires attention.

Legal Requirements.

Before a capital reduction scheme can be carried out it is necessary for the company to pass a special resolution, and also to obtain the sanction of the Court. In many cases the consent of creditors is also required. After the reduction the Court may order the words " and reduced " to be added to the name of the company. These comments are only intended to indicate the broad conditions attaching to a Capital Reduction Scheme. For fuller details the secretary should refer to Pitman's *Law of Joint Stock Companies.*

Accountancy Procedure.

The accounting entries may best be explained by furnishing examples of reduction schemes formulated

EXAMPLE "A." THE ORION CO., LTD.

SHARE CAPITAL ACCOUNT

Dr. *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Jan. 1	To Reduction of 10s. per share made under Order of the Court dated.....	Jnl.	100,000	–	–	Jan. 1	By Balance at this date .	b/d	200,000	–	–
,, 1	,, Balance . . .	c/d	100,000	–	–						
			£200,000	–	–				£200,000	–	–
						193..					
						Jan. 1	By Balance . . .	b/d	100,000	–	–

PROFIT AND LOSS APPROPRIATION ACCOUNT

Dr. *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Jan. 1	To Balance (accumulated losses) at this date .	b/d	100,472	–	–	Jan. 1	By Amount written off Issued Capital Account —10s. per share, under Order of Court dated....	Jnl.	100,000	–	–
						,, 1	,, Balance . . .	c/d	472	–	–
			£100,472	–	–				£100,472	–	–
193..											
Jan. 1	To Balance . . .	b/d	472	–	–						

EXAMPLE "A" (*contd.*). **THE ORION CO., LTD.**

EXTRACTS FROM BALANCE SHEETS

BEFORE REDUCTION

LIABILITIES	£	s.	d.	ASSETS	£	s.	d.
Authorized and Issued Capital—							
200,000 shares of £1 each . . .	200,000	–	–	Profit and Loss Appropriation Account .	100,472	–	–

AFTER REDUCTION

LIABILITIES	£	s.	d.	ASSETS	£	s.	d.
Authorized and Issued Capital—							
200,000 shares of 10s. each . . .	100,000	–	–	Profit and Loss Appropriation Account .	472	–	–

to deal (*a*) with trading losses only, and (*b*) with trading losses coupled with heavy depreciation of assets.

EXAMPLE (*a*). The Orion Co., Ltd., a company with an authorized and issued capital of £200,000 has made consistent losses. It decides eventually to deal with part of its debit balance of £100,472 on Appropriation Account by writing off 10s. per share of its issued capital (see pages 149 and 150).

EXAMPLE (*b*). The Orama Co., Ltd., a company with an authorized and issued capital of £500,000, decides to reduce its capital by writing off a debit balance of £100,472. It resolves to take the opportunity of writing off two intangible assets, Commission on Shares £2,078, and Preliminary Expenses £5,040. In addition, it is thought advisable to bring the plant and machinery down from its present value of £109,864 to its true value of £67,454. The Court sanctions the scheme and each £1 share is accordingly reduced by 6s. to a value of 14s. (see page 152).

Note. In cases such as these the secretary should always open an Intermediate Account in order to collect together the various " writings down." A suitable intermediate would be a " Capital Reduction Account."

Reduction of Paid Up Capital Out of Profits.

Before the passing of the Companies Act, 1929, it was possible to apply accumulated profits in reduction of paid-up share capital. This process was not subject to the approval of the Court, and needed only the sanction of the necessary resolutions of the shareholders. Under the Companies Act, 1929, the procedure is no longer available, and the only method of effecting this type of reduction is by submitting it to the Court for sanction.

Return of Excess Capital.

As distinct from a return of accumulated profits to shareholders, there is a procedure known as " Reduction

Example "B." THE ORAMA CO., LTD.

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		£	s.	d.	£	s.	d.
Capital Reduction Account	*Dr.*	150,000	–	–			
To Profit and Loss Appropriation Account					100,472	–	–
,, Commission on Shares					2,078	–	–
,, Preliminary Expenses					5,040	–	–
,, Plant and Machinery					42,410	–	–
		£150,000	–	–	£150,000	–	–
Amounts written off these Assets Accounts in accordance with resolution dated.....under Capital Reduction Scheme.							
Share Capital Account	*Dr.*	150,000	–	–			
To Capital Reduction Account.					150,000	–	–
Being amount written off Share Capital Account, 6s. per share on 500,000 shares, in accordance with Order of the Court dated.....							

EXAMPLE "A." THE ORPHEAN CO., LTD.

Dr. SHARE CAPITAL ACCOUNT *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Mar. 31	To Cash paid to Shareholders, 10s. per share in accordance with Order of Court dated	C.B.	250,000	–	–	Jan. 1	By Balance at this date— 500,000 shares of £1 each full paid . . .	b/f	500,000	–	–
,, 31	,, Balance . . .	c/d	250,000	–	–						
			£500,000	–	–				£500,000	–	–
						193.. Mar. 31	By Balance representing 500,000 shares of 10s. each fully paid . . .	b/d	250,000	–	–

EXAMPLE "A" (*contd.*). **THE ORPHEAN CO., LTD.**

EXTRACT FROM BALANCE SHEET

BEFORE RETURN OF SURPLUS CAPITAL AND EXTINCTION OF LIABILITY ON SHARES

LIABILITIES	£	s.	d.	ASSETS	£	s.	d.
Authorized Capital—				Cash at Bankers	300,000	–	–
500,000 shares of £1 each . . .	500,000	–	–				
Issued Capital—							
500,000 shares of £1 each, fully paid .	500,000	–	–				
Profit and Loss Appropriation Account .	5,000	–	–				

AFTER RETURN OF SURPLUS CAPITAL

LIABILITIES	£	s.	d.	ASSETS	£	s.	d.
Authorized Capital—				Cash at Bankers	50,000	–	–
500,000 shares of 10s. each . . .	250,000	–	–				
Issued Capital—							
500,000 shares of 10s. each, fully paid .	250,000	–	–				
Profit and Loss Appropriation Account .	5,000	–	–				

EXAMPLE "B." THE ORPHEAN CO., LTD.

SHARE CAPITAL ACCOUNT

Dr. *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Mar. 31	To Cash paid to Shareholders, 10s. per share in accordance with Order of Court dated	C.B.	250,000	–	–	Jan. 1	By Balance at this date— 500,000 shares of £1 each, fully paid . . .	b/f	500,000	–	–
,, 31	,, Balance . . .	c/d	250,000	–	–						
			£500,000	–	–				£500,000	–	–
						193.. Mar. 31	By Balance representing 500,000 shares of £1 each, 10s. paid . . .	b/d	250,000	–	–

EXTRACT FROM BALANCE SHEET

AFTER RETURN OF SURPLUS CAPITAL BUT RETAINING LIABILITY ON SHARES

LIABILITIES	£	s.	d.	ASSETS	£	s.	d.
Authorized Capital—							
500,000 shares of £1 each . . .	500,000	–	–	Cash at Bankers	50,000	–	–
Issued Capital—							
500,000 shares of £1 each, 10s. paid .	250,000	–	–				
Profit and Loss Appropriation Account .	5,000	–	–				

Note. The balance on Appropriation Account remains unaltered. It is included in both examples to demonstrate that it has no bearing on the scheme.

of Capital by Return of Excess Capital." This form of reduction requires the sanction of the Court, but it is far more likely to be approved than is a scheme for return of profits. The effect, as regards creditors, is practically the same, and it is not on their account that a distinction between the two methods is drawn. The real reason for the differentiation is that if profits are applied to a reduction of share capital, there is a loss to the Inland Revenue of super-tax on the dividends which would otherwise be declared.

A scheme for the return of surplus capital in reduction of share capital may either provide for the extinction of the shareholders' liability, or for its retention. The following examples illustrate both methods.

EXAMPLE "A." EXTINCTION OF LIABILITY. On 1st January the Orphean Co., Ltd., has an authorized and issued capital of £500,000 in shares of £1 each. It has a small credit balance on Profit and Loss Account of £5,000, but it has a balance of £300,000 with its bankers which—on account of a change in trade—it cannot employ usefully. The directors decide to reduce the capital of the company to £250,000 divided into shares of 10s. each fully paid, returning the sum of 10s. to the shareholders in respect of each share. The return is duly made on 31st March (see pages 153 and 154).

EXAMPLE "B." RETENTION OF LIABILITY. The directors of the Orphean Co., Ltd., adopt an alternative scheme under which the 10s. per share repaid serves to create an uncalled liability on the shareholders for a similar amount (see page 155).

Cancellation of Uncalled Capital.

A further instance of a capital reduction scheme which does not denote continued losses, is to be found in the cancellation of uncalled capital. This procedure is specifically authorized by Sect. 55 of the Companies Act, 1929, and whilst it can hardly be considered as

THE SUCCESS CO., LTD.

BALANCE SHEET AS AT 31st DECEMBER, 1933

BEFORE REDUCTION

LIABILITIES	£	s.	d.	ASSETS	£	s.	d.
Authorized Capital—				Freehold Land and Buildings at Cost	150,000	–	–
500,000 shares of £1 each	500,000	–	–	Stock-in-trade	100,000	–	–
				Sundry Debtors	50,000	–	–
Issued Capital—				Cash at Bankers	60,000	–	–
500,000 shares of £1 each, 10s. paid	250,000	–	–				
Sundry Creditors	10,000	–	–				
Profit and Loss Appropriation Account	100,000	–	–				
	£360,000	–	–		£360,000	–	–

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BALANCE SHEET AS AT 31st DECEMBER, 1933

AFTER REDUCTION

LIABILITIES	£	s.	d.	ASSETS	£	s.	d.
Authorized and Issued Capital—				Freehold Land and Buildings at Cost	150,000	–	–
500,000 shares of 10s. each, fully paid	250,000	–	–	Stock-in-trade	100,000	–	–
Sundry Creditors	10,000	–	–	Sundry Debtors	50,000	–	–
Profit and Loss Appropriation Account	100,000	–	–	Cash at Bankers	60,000	–	–
	£360,000	–	–		£360,000	–	–

falling within the purview of this present volume, it should not be overlooked by the secretary. There are no accountancy entries to be made in this type of capital reduction, except that the issued capital is differently described.

EXAMPLE. The Success Co., Ltd., has an issued capital of 500,000 shares, 10s. paid, the authorized capital being £500,000. As there is no possibility, contingent or remote, of a further call on the shareholders, it is decided to reduce the capital to £250,000, fully paid (see page 157).

Whilst such a reduction as that illustrated above does not call for entries in the accounts, the secretary is advised to record the dates of the various resolutions and of the sanction of the Court in an appropriate place in his private Ledger.

SELF-EXAMINATION QUESTIONS. XII

1. Set out the objects of a Capital Reduction Scheme.
2. What is the procedure to be followed by a company which desires to return to its shareholders paid-up capital which is in excess of the company's requirements?
3. May uncalled capital be cancelled? If so, under what circumstances and by what procedure?
4. The Xerxes Co., Ltd., has an issued and authorized capital of £500,000 in shares of £1 each. It has made losses which now amount to £250,000. The company decides to write off 10s. per share. Set out the procedure to be followed and give the consequent Ledger entries.
5. The Orestes Co., Ltd., has an issued capital of £750,000 in shares of £1 each, 15s. paid. It decides to cancel the liability of 5s. per share which is never likely to be required. What course must the company follow?

CHAPTER XIII

DEBENTURES

THE student who has followed closely the treatment of share capital in the preceding chapters should have little difficulty in dealing with debentures in a company's books of account. Prior to the Companies Act, 1929, there were certain differences in treatment, but now that it is possible to issue shares at a discount and to redeem preference shares, these differences have practically disappeared.

The particular aspects in the recording of debentures, to which the attention must be devoted, are—

(*a*) Issue of Debentures at Par.
(*b*) Issue of Debentures at a Premium.
(*c*) Issue of Debentures at a Discount.
(*d*) Repayment of Debentures at a Premium.
(*e*) Conversion of Debentures into Shares.

These are the matters which are examined in the following pages. The reader is recommended to refresh his memory, at this juncture, on the earlier points connected with debentures—particularly Redemption Accounts and Funds. These were studied fully in Chapter VII.

Nature of Debenture.

A debenture is a document of title held by a creditor in respect of cash advanced to the company. The title may give the holder a fixed charge or mortgage on the fixed assets as security for his advances; or it may confer a floating charge over the assets which charge will crystallize in case of default.

Debentures may be perpetual or redeemable. In the former case the company retains the cash advanced

by the debenture holder permanently. This retention is specifically authorized by Sect. 74 of the Companies Act, 1929, and overrides the old rule that the equity of redemption can never be obstructed. In the case of redeemable debentures there is usually a stated date for redemption, although it is possible to stipulate that redemption shall be at the option of the company. If the debentures are redeemed then Sect. 75 permits their reissue, provided the company's own regulations do not forbid such a course.

For further details of the legal matters governing debentures, the reader should study carefully Pitman's *Law of Joint Stock Companies*.

Issue of Debentures at Par.

The issue of debentures at par is a simple matter to record. If arrangements have been made for applicants to pay for the issue by instalments, then Call Accounts are opened exactly as in the case of Share Capital Issues.

EXAMPLE. The Georgian Co., Ltd., makes an issue of £500,000 6 per cent mortgage debentures at par, payable as to 25 per cent on application, 25 per cent on allotment, and 50 per cent on First and Final Call Account one month after allotment. The debentures are in multiples of £100. Excess applications for £120,000 of debentures have to be returned. It is required to show the above issue (including cash) in the form of Journal entries (see page 161).

Issue at a Premium.

The entries relating to an issue of debentures at a premium are also similar to those made to record an issue of shares at a premium. The premium, which may be payable with the application money or with one of the calls, is posted to " Premium on Debentures Account." This account represents a capital " profit "

THE GEORGIAN CO., LTD.
ISSUE OF 6 PER CENT DEBENTURES AT PAR
JOURNAL

191			£	s.	d.	£	s.	d.
193.. Jan. 1	6 per cent Mortgage Debenture Application and Allotment Account . *Dr.* To 6 per cent Mortgage Debentures Account . . . . . . Amount payable in respect of Application and Allotment money on issue of £500,000 debentures at par.		250,000	–	–	250,000	–	–
,, 1	Cash . . . . . *Dr.* To Application and Allotment Account . . . . . . Subscriptions of 25 per cent received in respect of applications for £620,000 debentures.		155,000	–	–	155,000	–	–
,, 1–8	Application and Allotment Account . . . . . *Dr.* To Cash . . . . . . Amounts returned to applicants for £120,000 debentures not allotted.		30,000	–	–	30,000	–	–
,, 8	Cash . . . . . *Dr.* To Application and Allotment Account . . . . . . Amount received in respect of allotments of £500,000 debentures.		125,000	–	–	125,000	–	–
Feb. 8	6 per cent Mortgage Debentures First and Final Call Account . . *Dr.* To 6 per cent Mortgage Debentures Account . . . . . . Amount payable (50 per cent) on First and Final Call in respect of £500,000 debentures.		250,000	–	–	250,000	–	–

THE GEORGIAN CO., LTD.
ISSUE OF 6 PER CENT DEBENTURES AT A PREMIUM
JOURNAL

193..			£	s.	d.	£	s.	d.
Jan. 1	6 per cent Mortgage Debentures Application and Allotment Account .	*Dr.*	275,000	–	–			
	To 6 per cent Mortgage Debentures Account					250,000	–	–
	,, Premium on Debentures Account					25,000	–	–
	Amount payable in respect of Application and Allotment money on issue of £500,000 debentures and premium of 5 per cent on amount offered.							
,, 1–8	Cash	*Dr.*	186,000	–	–			
	To 6 per cent Mortgage Debentures Application and Allotment Account .					186,000	–	–
	Subscriptions of 25 per cent plus 5 per cent premium received in respect of applications for £620,000 debentures.							
,, 1–8	6 per cent Mortgage Debentures Application and Allotment Account .	*Dr.*	36,000	–	–			
	To Cash					36,000	–	–
	Amounts returned to applicants for debentures not allotted (25 per cent of £120,000, £30,000, and 5 per cent premium on same, £6,000.)							

and, as such, should not be transferred to Profit and Loss Account for distribution by way of dividend. It must be carried forward on the Liabilities side as a separate item or transferred to a Capital Reserve Account. Occasionally it is transferred to Debenture Redemption Account and constitutes the first contribution set aside for redemption purposes.

It is not necessary to illustrate an issue of debentures at a premium fully, but the Journal entries given on page 162 deal with the issue of £500,000 debentures of the Georgian Co., Ltd. It is assumed, in this instance, that a premium of 5 per cent is payable with the application money of 25 per cent. The amount payable on allotment is 25 per cent. The over-subscription is the same as in the preceding example.

Issue at a Discount.

In an issue of debentures at a discount the full nominal amount is credited to the Debentures Account, and the discount is debited to " Discount on Debentures Account." This account is carried forward separately on the Assets side of the Balance Sheet until it has been written off; this procedure is not optional, but is laid down specifically in Sect. 44 of the Companies Act, 1929.

The debiting of the discount to " Discount on Debentures Account " is sometimes left over until the Final Call Account is entered in the Journal. This practice is not very sound, and the secretary is advised to deal with the discount when opening the Application and Allotment Account. The appropriate Journal entry may be illustrated by the example given on page 164, which again is based on the issue made by the Georgian Co., Ltd. The debentures, on this occasion, are assumed to have been issued at 95 in instalments of 20 per cent, 25 per cent, and 50 per cent.

THE GEORGIAN CO., LTD.
ISSUE OF DEBENTURES AT A DISCOUNT
JOURNAL

193..			£	s.	d.	£	s.	d.
Jan. 1	6 per cent Mortgage Debentures Application and Allotment Account	*Dr.*	225,000	–	–			
	Discount on Debentures Account	*Dr.*	25,000	–	–			
	To 6 per cent Mortgage Debentures Account					250,000	–	–
	Amount payable on Application and Allotment (45 per cent) in respect of £500,000 debentures issued at a discount of 5 per cent (£25,000).							

Writing Off Discount.

Whilst the Companies Act, 1929, stipulates that the Discount on Debentures must be retained in a company's Balance Sheet until written off, it does not provide any rules as to the method by which it shall be extinguished. This, then, is one of the matters upon which the advice of the secretary is likely to be sought by his directors. He should consider the particular circumstances of his company's issue and prepare a method for amortizing the discount which will give full weight to those circumstances. It is impossible to list all possible methods in this present volume, but a reference to one or two common alternatives may prove beneficial.

If the debentures are perpetual then any system of amortization is suitable, the only factor needing consideration being the company's own convenience. If, on the other hand, the debentures are redeemable then it is usual to adopt such a scheme of writing-off as will ensure the extinction of the Debenture Discount by the time the debentures have been fully repaid. For example, issues of debentures are sometimes made with the proviso that an equal amount shall be repaid each year during the full term of the issue. In such cases it is clear that the company has the use of the greatest amount of money in the first year, and that thereafter there is an equal annual diminution. The secretary could, therefore, calculate appropriate rates of amortization which would be proportionate to the benefit derived by the company from the debentures in each of the years. The discount written off in the earlier years would then be heavier than in the later years. An illustration of this type of calculation is given on page 167, marked Method "B."

If the debentures have been issued with a stipulation that they shall be repaid all at once at the end of a specified term, then the discount may correctly be

divided by the number of years in the term and one of the resultant equal instalments written off each year. An illustration of this method is given on page 167, marked Method "A."

EXAMPLE. The A B Co. is considering the issue of £500,000 in debentures at a discount of 10 per cent. The directors are considering two alternative schemes, one ("A") redeeming the debentures by annual drawings of £50,000 per annum, and the other (" B ") stipulating that redemption of the full issue shall be made at the latest redemption date. It is required to show the discount calculations appropriate to each method, no other accounts being called for by the directors for the present (see page 167).

Repayment of Debentures at a Premium.

From time to time the secretary encounters debentures issued at par but repayable at a premium. In these cases the company's liability, during the currency of the debentures, is represented by the par value only. At the redemption date, however, the liability is increased by the amount of the premium. On these grounds the debentures appear in the accounts at par, with a note as to the date of redemption and the premium due when that date arrives. The Redemption Account or Redemption Fund, built up for the repayment of the debentures, should be calculated to provide for the premium as well as for the par value of the debentures. On this particular point the student should again turn to Chapter VII and re-read the paragraphs which explained the working of Debenture Redemption Accounts.

Reissue of Redeemed Debentures.

Unless a company's Articles of Association—or its Debenture Trust Deed—specifically forbid, it is possible to reissue redeemed debentures. This right is conferred

	Method "A"		Method "B"		
	Debentures Outstanding	Charge	Debentures Outstanding	Proportion	Charge
	£	£	£		£
During 1st year . . .	500,000	5,000	500,000	$\frac{10}{55}$	9,090·90
,, 2nd ,, . . .	500,000	5,000	450,000	$\frac{9}{55}$	8,181·81
,, 3rd ,, . . .	500,000	5,000	400,000	$\frac{8}{55}$	7,272·72
,, 4th ,, . . .	500,000	5,000	350,000	$\frac{7}{55}$	6,363·63
,, 5th ,, . . .	500,000	5,000	300,000	$\frac{6}{55}$	5,454·54
,, 6th ,, . . .	500,000	5,000	250,000	$\frac{5}{55}$	4,545·45
,, 7th ,, . . .	500,000	5,000	200,000	$\frac{4}{55}$	3,636·36
,, 8th ,, . .	500,000	5,000	150,000	$\frac{3}{55}$	2,727·27
,, 9th ,, . . .	500,000	5,000	100,000	$\frac{2}{55}$	1,818·18
,, 10th ,, . . .	500,000	5,000	50,000	$\frac{1}{55}$ (say)	909·14
					£50,000·00

by Sect. 75 of the Companies Act, 1929, which stipulates that particulars of the debentures which can be reissued shall be inserted in the company's Balance Sheet.

The secretary should note carefully that a reissue of redeemed debentures is regarded as a new issue for the purposes of stamp duty.

Conversion of Debentures.

A company may issue debentures to which there is attached a provision permitting conversion into shares. This provision must not be framed in such a way as to lead to the issue of shares at a discount. For example, a company may not issue debentures of £100 nominal value at 80 and then permit the conversion of those debentures into shares at the rate of 100 shares of £1 each fully paid in respect of each £100 of debenture.

If the debentures have been issued at par then there is no difficulty. A simple Journal entry is all that is necessary, transferring the balance on Debentures Account to Share Capital Account.

EXAMPLE. The Hercules Co., Ltd., which has an authorized capital of £100,000, £50,000 issued, also has outstanding £50,000 of 6 per cent debentures issued at par. At the redemption date the holders request the conversion of their debentures into fully paid shares. The company decides to do so, and the entry set out on page 169 is made in the Journal.

Conversion of Debentures Issued at a Discount.

If shares are allotted in conversion of debentures issued at a discount, then the maximum number of shares will be the equivalent of the cash subscribed by the debenture holders. This rule will be clear if the following illustration is studied carefully.

EXAMPLE. The Hercules Co., Ltd., has on 1st January issued £50,000 6 per cent debentures at 90 per cent.

THE HERCULES CO., LTD.

CONVERSION OF DEBENTURES INTO SHARES

Date			£	s.	d.	£	s.	d.
	6 per cent Debentures Account . . . . . *Dr.*		50,000	–	–			
	To Issued Share Capital Account					50,000	–	–
	Conversion of £50,000 6 per cent debentures into 50,000 shares of £1 each fully paid in accordance with Board minute dated .....and Clause..... of Debenture Trust Deed.							

THE HERCULES CO., LTD.
CONVERSION OF DEBENTURES ISSUED AT A DISCOUNT
ISSUED SHARE CAPITAL ACCOUNT

Dr. *Cr.*

					193..			£	s.	d.
					Jan. 1	By Balance at this date .	b/d	50,000	–	–
					,, 31	,, Conversion Account—Issue of 45,000 shares fully paid in exchange for £50,000 6 per cent debentures	Jnl.	45,000	–	–
							£	95,000	–	–

Dr.

6 PER CENT DEBENTURES ACCOUNT

Cr.

193..			£	s.	d.	193..			£	s.	d.
Jan. 31	To Transfer to Conversion Account	Jnl.	50,000	–	–	Jan. 1	By Balance at this date .	b/d	50,000	–	–
		£	50,000	–	–			£	50,000	–	–

THE HERCULES CO., LTD.

CONVERSION OF DEBENTURES ISSUED AT A DISCOUNT (*continued*)

Dr. **CONVERSION ACCOUNT** *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Jan. 31	To Issued Share Capital Account—Issue of 45,000 shares of £1 each fully paid	Jnl.	45,000	–	–	Jan. 31	By Transfer of Nominal Value of £50,000 debentures	Jnl.	50,000	–	–
,, 31	,, Transfer of Premium arising on Conversion to "Discount on Debentures"	Jnl.	5,000	–	–						
		£	50,000	–	–			£	50,000	–	–

Dr. **DISCOUNT ON DEBENTURES ACCOUNT** *Cr.*

193..			£	s.	d.	193..			£	s.	d.
Jan. 1	To Balance at this date (representing discount of 10 per cent on issue of £50,000 debentures at 90)	b/d	5,000	–	–	Jan. 1	By Conversion Account, representing premium on Conversion of debentures into shares written off against discount on debentures	Jnl.	5,000	–	–
			£5,000	–	–				£5,000	–	–

These debentures are now to be converted on 31st January into 45,000 shares of £1 each fully paid (see pages 170 and 171).

If the Hercules Co., Ltd., had already written off its "Discount on Debentures Account" out of previous profits, then the "profit" of £5,000 appearing on Conversion Account would have been transferred to "Premium on Shares Account."

SELF-EXAMINATION QUESTIONS. XIII

1. What is a Debenture? Set out briefly its place in joint stock company finance.

2. May debentures be issued at a discount or at a premium? If so, what procedure must be followed by the secretary in recording such issues.

3. Tabulate the method of converting debentures into shares, and enumerate the rules governing this process.

4. A limited company issued 200,000 Preference Shares of £1 each at 22s. 6d. per share, and £80,000 Debentures at a premium of 5 per cent; which were all subscribed and fully paid up. Make the necessary Journal, Cash Book, and Ledger entries, and draw up Trial Balance and Balance Sheet.

5. The Zodiac Co. issues £500,000 of 6 per cent First Mortgage Debentures at 98 redeemable over ten years by equal annual drawings, commencing five years after issue. Set out the entries necessary to record the issue and the method you would adopt for dealing with the discount.

CHAPTER XIV

STATUTORY BOOKS

PRIOR to the passing of the Companies Act, 1929, the statutory books of a company consisted of—

(*a*) The Minute Book.
(*b*) The Register of Members.
(*c*) The Register of Mortgages.
(*d*) The Register of Directors.

Under the 1929 Act the list of books which must be kept to comply with statute has been somewhat increased.

Sect. 122 of that Act stipulates that books of account shall be kept to record cash receipts and payments, the sales and purchases of the company, and details of all liabilities and assets. Sect. 274 lays down that a company must keep—at least during the two years preceding any eventual liquidation—statements of the annual stock-takings. This section also specifies that the names of the buyers and sellers of the company's goods must be recorded. It is not suggested that these two sections enforce the keeping of any records which a prudent and efficient secretary would not keep voluntarily. The matter only arises because it is necessary to understand that the term "statutory books" is, perhaps, wider than is generally supposed.

It is only with such statutory books as the Registers of Members and Directors that this present chapter is concerned.

Register of Members.

The Register of Members which has to be kept under the Companies Act, 1929, is scarcely different from that kept before the passing of that Act. Its form and ruling are not fixed by statute and, in consequence,

there are many types of register in use all varying slightly in the amount of detail they give. The register itself must either be kept in such a way that its form constitutes an index, or it must be accompanied by a card index containing sufficient information to enable speedy reference to be made to any name in the register (Sect. 96). This stipulation does not, however, apply to companies having fifty or less than fifty members.

CONTENTS OF REGISTER. The Register of Members must contain the following information—

1. The name of every member.
2. The address of every member.
3. The occupation of every member.
4. A statement of the number of shares held by each member, with the distinguishing numbers of the shares.
5. A statement of the amount paid or agreed to be considered paid on each share.
6. The date at which each person was entered in the register.
7. The date at which any person ceased to be a member.

If the shares of a company have been converted into stock, then the register must show the amount of stock held by every member.

Issue of Share Warrants.

In the event of the issue of share warrants under the provisions of Sect. 97, then the Register of Members must be amended accordingly. The name of the member is to be struck out and entries made recording the issue of the warrant, the shares included in the warrant, and the date on which the warrant was issued.

Specimen Register of Members.

A particularly useful Share Register is one that records the exact state of each member's payments on account of calls. The working of this type of Share

REGISTER OF MEMBERS

Name..... Date of Entry as a Member.....

Address..... Date of Ceasing to be a Member.....

Occupation.....

Dr. CASH ACCOUNT *Cr.*

Date	Particulars	Folio	Call per Share £	Call per Share s.	Call per Share d.	Total Amount Called £	Total Amount Called s.	Total Amount Called d.	Date	Particulars	Folio	Total Amount Paid £	Total Amount Paid s.	Total Amount Paid d.

Dr. SHARES ACCOUNT *Cr.*

Shares Acquired						Shares Transferred					Balance		
Date	Folio	Number	Distinctive Numbers From	Distinctive Numbers To	Amount Paid Up £ s. d.	Date	Folio	Number	Distinctive Numbers From	Distinctive Numbers To	Number	Nominal Value £ s. d.	

Register is explained very fully in *Practical Secretarial Work*, by Lee and Barr (Pitman, 7s. 6d. net).

A specimen of the ruling of the book is given on page 175.

Register of Mortgages.

The usual form of Register of Mortgages is simple, as will be seen from the illustration on page 177.

The secretary must be acquainted with the charges which require to be entered in the register. They are set out in detail in Sect. 79 of the Companies Act, 1929, and may be summarized as follows—

1. Charges for the purpose of securing issues of debentures.
2. Charges on uncalled share capital.
3. Such charges as would, if executed by individuals, constitute bills of sale.
4. Mortgages on land.
5. Charges on book debts, ships, goodwill, patents or trade-marks.
6. Floating charges on the company's property.

The register must be kept up to date always, and must be ready and available for inspection by the public on payment of a fee not exceeding 1s.

Register of Directors.

The keeping of a Register of Directors is laid down in Sect. 144 of the Companies Act, 1929. Particulars must be entered as to—

1. The present Christian name and surname of each director.
2. Any former names.
3. Address and nationality and also particulars of any former nationality.
4. Business occupation or other directorships.

If the company is under the control of another

REGISTER OF MORTGAGES AND CHARGES

No.	Date of Creation	Mortgagee's		Amount	Property Charged	Rate of Interest	Remarks
		Name	Address	£ s. d.			

12—(2030)

REGISTER OF DEBENTURE HOLDERS

Folio..... .....

Name..... Address.....

Description..... .....

Debentures Acquired						Redeemed, Converted, or Transferred						Balance					
Date	Transfer	Certificate	Amount			Date	Transfer	Amount				Date	Certificate	Amount			
			£	s.	d.			£	s.	d.				£	s.	d.	

limited company which manages its affairs as would directors, then the name and the registered office of that company must be entered in the register.

Register of Debenture Holders.

It is usual, in the case of public issues of debentures, to arrange for the mortgage of the company's property to be entered in the name of a trustee or trustees. When this is done then the names of the trustees only are recorded in the Register of Mortgages. This practice is not always convenient, and so the secretary often keeps a separate Register of Debenture Holders as well.

There is no obligation to keep such a book, but if one is kept then the regulations set out in Sect. 73 must be observed. This section provides, *inter alia*, that the register must be open to inspection by the holders of the debentures or by the shareholders, except when duly closed as provided by the Act.

A convenient ruling for a Debenture Holders' Register is given on page 178.

Other Books of Memorandum.

From time to time the secretary will find a need to employ other books of memorandum, particularly for use as subsidiary books to the statutory registers. We may quote by way of examples the various Calls Cash Books, to which we have already referred. Then there are such books as Transfer Registers, Registers of Powers of Attorney, Seal Register, Register of Probates, and Dividend Books. The rulings of these books have not been laid down by statute, and the secretary is free to devise them to suit the requirements of his own particular company. The only one which need be illustrated here is the Transfer Register. The ruling of this register is based upon one which is in fairly common use, and is shown on page 180.

TRANSFER REGISTER

Transferor					Transferee				
Date	Name	Folio	Number of Shares	Distinctive Numbers	Name	Address	Description	Folio	Certificate Numbers, etc.

SELF-EXAMINATION QUESTIONS. XIV

1. Draw up a specimen Register of Members and insert six illustrative entries therein.

2. Give a list of the statutory books to be kept by a company?

3. What entries have to be made in the Register of Mortgages? Give a *pro forma* ruling of this book.

4. Make a short précis of the uses served by a Transfer Register. Set out a ruling with specimen entries.

5. On 15th May, the directors of the Ornis Aeroplane Co., Ltd., made a first call of 5s. per share on the Preference Shares. The call was payable by 25th May, and the following amounts were received—

May 17.	D. Palmer . .	2,000	Shares	£300
17.	I. Minns . .	2,000	,,	500
18.	T. James . .	3,000	,,	750
19.	F. Hallett . .	2,000	,,	500
20.	E. Herrick . .	2,000	,,	500
21.	F. Grover . .	5,000	,,	750
22.	E. Figgs . .	1,000	,,	250
23.	N. Dowse . .	5,000	,,	1,250
24.	W. Clarke . .	1,000	,,	375
25.	H. Colley . .	2,000	,,	500

Palmer and Grover were allowed till 25th June to pay the balance, subject to interest at 5 per cent, on which date the amounts due (plus interest) were duly received. Write up the Call Book and the subsidiary Cash Book.

SECTION III

GENERAL ACCOUNTS

In Section II we studied the secretary's duties with regard to the accounts of limited companies, except in connection with the preparation and presentation of annual or other periodical accounts. This matter forms the subject of Section IV, whilst the present Section (No. III) deals only with general accountancy problems, such as joint ventures, royalty accounts, and so on. The interposing of these miscellaneous accounts at this stage has been done with a definite object. They do not necessarily enter into the accounts of every limited company; at the same time any secretary may be called upon to deal with them should his company enter into agreements with other parties, in which these miscellaneous accountancy matters are involved. To give an example we can quote Partnership Accounts. It may, perhaps, seem unnecessary for the company secretary to devote much time to the study of these accounts. Such a view is, however, erroneous. At any time a limited company may decide to purchase a business carried on by a partnership, and the secretary may be called upon to advise as to the closing of the old accounts and the incorporation of new accounts in his own books. The late partnership will probably employ their own accountants to prepare the dissolution accounts, but it is by no means beyond the bounds of possibility that the secretary of the purchasing company will be requested to supervise the work. In any case, the secretary should be so well versed in the preparation of partnership Balance Sheets, that he can be regarded competent to offer advice to his board on any proposed purchase of a partnership business.

Finally, the secretarial student—as distinct from the secretary—cannot neglect the study of the general accounts which form the subject matter of this part of the book. His examination syllabus definitely demands that they be given as much attention as the accounts relating exclusively to limited companies.

CHAPTER XV

PARTNERSHIP ACCOUNTS

Partnership Rules.

The keeping of partnership accounts is generally governed by a deed of partnership. This deed lays down regulations for the conduct of the business, for the keeping of books, for the allowance of interest on capital, for the division of profit, and for the hundred other items which necessarily arise when two or more persons join together in running a business in partnership.

It is quite possible, however, for a partnership to be formed and carried on without a deed. The rules are then agreed upon verbally, but in the absence of agreement then the Partnership Act of 1890 applies. This Act governs all partnerships in so far as there is no agreement—express or implied—to the contrary.

Section 24, Partnership Act, 1890.

The principal section of the Partnership Act which should be studied by the secretary is Sect. 24. It lays down, among other things, the following rules as to accounts which apply to all partnerships in which no other definite arrangements have been made—

1. All partners must share equally in the capital, the profits, and the losses of the partnership.

2. No interest is to be charged against profits in respect of partners' capital.

3. Interest at 5 per cent may be allowed on advances made by partners as distinct from capital contributions.

4. Every partner has an equal voice in the management of the business.

5. No remuneration is payable to any partner for acting in the business.

6. The partnership books must be open for inspection by any partner.

Preparation of Accounts.

Any accounts relating to partnerships in which no express conditions have been agreed upon, must be drawn up to conform with the rules set out above.

EXAMPLE. Mercia & Co., a partnership consisting of Grantson and Wrentworth, have no partnership deed, and are governed by the Partnership Act of 1890. The capital of each partner is £5,000, but Wrentworth has in addition advanced £4,000 to the firm. Wrentworth is the working partner and Grantson takes no active part in the management. It is required to show the Appropriation Account for the year ended 31st December, 1932, assuming that a profit of £946 has been earned. Each partner has drawn £350 from the business during the year in anticipation of profit. Income-tax is to be ignored (see page 186, Example "A").

It will be noted that the fact that Wrentworth is the working partner has no effect on the division of profits; in the absence of agreement no salaries are payable to partners.

Effect of Partnership Agreement.

The effect of a partnership deed or agreement may be very considerable, and will be illustrated by a second example based on the accounts of the firm of Mercia & Co.

EXAMPLE. Grantson and Wrentworth are in partnership as Mercia & Co. under somewhat similar conditions to those given in the preceding example. In this case, however, the following rules are laid down in a partnership deed—

(*a*) Wrentworth is to receive a salary of £250.
(*b*) Grantson is to be allowed to withdraw, and does

MERCIA AND CO.

EXAMPLE "A"

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT FOR THE YEAR ENDED 31st DECEMBER, 1932 *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Dec. 31	To Interest at 5 per cent on Loan by Wrentworth	Jnl.	200	–	–	Dec. 31	By Net Profit for the year transferred from Profit and Loss Account	b/d	946	–	–
,, 31	,, Transfer of Profits to Partners' Capital Accounts—										
	Grantson	Jnl.	373	–	–						
	Wrentworth	Jnl.	373	–	–						
			£946	–	–				£946	–	–

EXAMPLE "B"

Dr. PROFIT AND LOSS APPROPRIATION ACCOUNT *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Dec. 31	To Partner's Salary—Wrentworth	Jnl.	250	–	–	Dec. 31	By Net Profit for the year transferred from Profit and Loss Account	b/d	946	–	–
,, 31	,, Interest on Loan by Wrentworth	Jnl.	200	–	–						
,, 31	,, Interest on Capital—										
	Grantson	Jnl.	200	–	–						
	Wrentworth	Jnl.	250	–	–						
,, 31	,, Transfer of Profits to Partner's Capital Accounts—										
	Grantson	Jnl.	23	–	–						
	Wrentworth	Jnl.	23	–	–						
			£946	–	–				£946	–	–

MERCIA AND CO.—EXAMPLE "B" (*continued*)

F. GRANTSON—CAPITAL ACCOUNT

Dr. *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Jan. 1	To Withdrawal in Cash	C.B.	1,000	–	–	Jan. 1	By Balance	b/f	5,000	–	–
Dec. 31	,, Balance	c/d	4,000	–	–						
			£5,000	–	–				£5,000	–	–
						1933					
						Jan. 1	By Balance	b/d	4,000	–	–

F. GRANTSON—CURRENT ACCOUNT

Dr. *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Dec. 31	To Drawings during year	C.B.	350	–	–	Dec. 31	By Interest on Capital	Jnl.	200	–	–
						,, 31	,, Share of Profits per Profit and Loss Account	Jnl.	23	–	–
						,, 31	,, Balance	c/d	127	–	–
			£350	–	–				£350	–	–
1923											
Jan. 1	To Balance	b/d	127	–	–						

MERCIA AND CO.—EXAMPLE "B" (*continued*)

Dr. **M. WRENTWORTH—CURRENT ACCOUNT** *Cr.*

1932			£	s.	d.	1932			£	s.	d.
Dec. 31	To Drawings during year . .	C.B.	350	–	–	Dec. 31	By Interest on Capital . .	Jnl.	250	–	–
,, 31	,, Balance	c/d	123	–	–	,, 31	,, Interest on Loan . .	Jnl.	200	–	–
						,, 31	,, Share of Profits per Profit and Loss Account . . .	Jnl.	23	–	–
			£473	–	–				£473	–	–
						1933 Jan. 1	By Balance	b/d	123	–	–

Dr. **M. WRENTWORTH—CAPITAL ACCOUNT** *Cr.*

						1932			£	s.	d.
						Jan. 1	By Balance	b/f	5,000	–	–

so withdraw, £1,000 of his capital on 1st January, 1932.

(*c*) Interest is to be allowed on the partners' fixed capital at 5 per cent, but no interest is to be charged on drawings.

(See specimens of accounts on pages 186, 187, and 188, Example "B.")

Partners' Accounts.

One Personal Account only for each partner may be kept, or there may be a separate account for capital and a separate account for drawings, etc. Partners' Loan Accounts, however, are always kept apart.

If the partnership deed stipulates that the Capital Account is to be kept at a fixed amount, then the drawings and any other adjustments must not be deducted from, or added to, the partners' capitals. The same remark applies if it is agreed that interest shall be allowed on the original Capital Accounts every year. If, on the other hand, it is agreed that interest shall be allowed on the amount standing to the credit of each partner's account as at the beginning of the year, then one account only need be kept.

In both the illustrations relating to Mercia & Co. which we have given, it would be advisable to keep separate Current Accounts for each partner, leaving the Capital Accounts intact; the reason for this is that although no interest on capital is included in the first example, Wrentworth's account will be greater than Grantson's by the amount of the interest on his loan.

Interest on Drawings.

Whilst it is quite usual to allow interest on the balances on partners' Capital Accounts as from the date of the preceding Balance Sheet, it is not very common to allow interest on drawings during the year. In many cases the drawings of partners are identical

in amount and are made on the same dates; there is no necessity, under these circumstances, to trouble to calculate interest on the respective withdrawals. There are other cases, however, in which the drawings are definitely unequal, and this factor leads to the inclusion of a clause in the partnership deed as to the charging of interest on the periodical amounts withdrawn in anticipation of profits.

The corresponding credit in respect of the interest charged is made either to Profit and Loss Account or to Appropriation Account. The latter course is the more correct as the item is more in the nature of an adjustment between partners than a credit to trading profits.

EXAMPLE. James Morgan and Elijah Pearson are in partnership, sharing profits equally. Morgan has drawn £500 on account of profits, half-way through the year, on 30th June. Pearson has drawn £120 on 1st February, £40 on 1st April, £220 on 1st July, and £200 on 1st October. The profits amount to £1,478 5s. It is required to show the partners' Current Accounts for the year, allowing interest at 5 per cent. Any balances on Current Accounts are transferred to Capital Account at the end of each year. Income-tax to be ignored (see pages 191 and 192).

Preparation of Accounts.

The preparation and presentation of Partnership Accounts does not give rise to any complications. The compilation of a Profit and Loss Account and Balance Sheet from a Trial Balance proceeds exactly as in the illustrations we have already considered. It is only in regard to the distribution of profits and the treatment of drawings that any difference arises. The special procedure as to the arranging of the Trial Balance in proper order, and as to the inclusion of all reserves and adjustments in the Trial Balance itself, will be found just as

Dr. JAMES MORGAN—CURRENT ACCOUNT *Cr.*

Date			Interest			Amount			Date			Amount		
193..			£	s.	d.	£	s.	d.	193..			£	s.	d.
June 30	To Cash—in respect of Drawings .	Jnl.	12	10	–	500	–	–	Dec. 31	By Appropriation Account— Share of Profit . . .	Jnl.	739	2	6
Dec. 31	,, Interest . .					12	10	–						
,, 31	,, Transfer to Capital Account . .	Jnl.				226	12	6						
						£739	2	6				£739	2	6

Dr. ELIJAH PEARSON—CURRENT ACCOUNT *Cr.*

Date			Interest			Amount			Date			Amount		
			£	s.	d.	£	s.	d.				£	s.	d.
193..									193..					
Feb. 1	To Cash—in respect of Drawings	Jnl.	5	10	–	120	–	–	Dec. 31	By Appropriation Account—Share of Profit	Jnl.	739	2	6
Apr. 1	,, do. do.	Jnl.	1	10	–	40	–	–						
July 1	,, do. do.	Jnl.	5	10	–	220	–	–						
Oct. 1	,, do. do.	Jnl.	2	10	–	200	–	–						
Dec. 31	,, Interest					15	–	–						
,, 31	,, Transfer to Capital Account					144	2	6						
						£739	2	6				£739	2	6

advantageous as in the case of limited companies' accounts. In order to demonstrate the advantages of the procedure when applied to the preparation of Partnership Accounts, the following example is given.

The firm of Strong, Dawson, and Fenton are in partnership, sharing profits in the ratio of 3 : 2 : 1. They extract a Trial Balance from their books at 30th June, 1936, which is illustrated on pages 194 and 195. Certain adjustments have been incorporated in the Trial Balance in accordance with the method explained in Chapter V. These adjustments, which are distinguished by italics, relate to the following—

(*a*) Interest at 5 per cent is to be allowed on Partners' Capitals, but no interest is chargeable on Drawings.

(*b*) Strong and Dawson are to be credited with Management Salaries of £750 and £375 respectively.

(*c*) Depreciation is to be charged at 7½ per cent on Machinery and 5 per cent on Fixtures, calculated on opening balances.

(*d*) The Reserve for Bad Debts is to be adjusted to an amount equal to 5 per cent of the Sundry Debtors.

(*e*) Rent of Warehouse has been paid in advance to the extent of £48, and a reserve has to be made for Gas, Lighting, and Heating to the extent of £72 8s. 8d.; this charge is applicable to the factory.

(*f*) The Stock-in-trade at the end of the year was valued: Raw Materials £4,878 2s. 2d., and Finished Goods £9,242 7s. 7d.

The accounts based on the foregoing are given on pages 196 to 199.

Examination Procedure.

The attention of the secretarial examination candidate is drawn to the break which has been made in the accounts of Strong, Dawson, and Fenton to distinguish

STRONG, DAWSON, AND FENTON
TRIAL BALANCE—30th JUNE, 1936

Folio		£	s.	d.	£	s.	d.
	Expenses and Income—						
38	Wages	22,998	2	6			
49	Freight and Carriage Inwards	2,862	4	9			
66	Purchases of Raw Material	25,692	3	3			
—	Increase/Decrease in Raw Material—						
23	Stock at 1st July, 1935	5,902	6	8			
—	*Stock at 30th June, 1936*				4,878	2	2
47	Power	1,182	3	3			
98	Gas, Lighting, and Heating (Factory)	403	2	7			
—	*Gas, Lighting, and Heating Accrued Due*	72	8	8			
125	Sales				66,792	3	3
—	Increase/Decrease in Finished Stocks—						
132	Stock at 1st July, 1935	7,989	4	8			
—	*Stock at 30th June, 1936*				9,242	7	7
140	Rent of Warehouse	156	9	2			
—	*Rent of Warehouse Paid in Advance*				48	–	–
142	Salaries	3,789	2	6			
147	Rates	764	2	2			
188	Insurance	73	8	9			
162	Discounts Allowed	488	2	6			
166	Discounts Received				330	2	3
173	Bad Debts written off	78	3	3			
—	*Additional Reserve for Bad Debts*	227	18	10			
179	General Expenses	662	3	9			
—	*Depreciation at 7½ per cent on Machinery*	697	10	–			
—	*Depreciation at 5 per cent on Fixtures*	105	–	–			
—	*Interest on Partners' Capitals—Strong*	750	–	–			
—	*Dawson*	750	–	–			
—	*Fenton*	1,250	–	–			
—	*Partners' Management Salaries—Strong*	750	–	–			
—	*Dawson*	375	–	–			
	Assets and Liabilities—						
C.B.	Cash at Bankers	30,581	11	9			
	carried forward	108,600	9	–	81,290	15	3

TRIAL BALANCE (*continued*)

Folio	*Assets and Liabilities*—	£	s.	d.	£	s.	d.
	brought forward	108,600	9	–	81,290	15	3
232	Freehold Land and Buildings	14,502	–	–			
250	Partners' Capital Accounts—Strong				15,000	–	–
251	Dawson				15,000	–	–
252	Fenton				25,000	–	–
259	Bills Payable				25,104	2	9
263	Plant and Machinery as at 1st July, 1935	9,300	–	–			
264	Plant and Machinery, Additions during year	402	3	8			
—	*Depreciation on Plant and Machinery at 7½ per cent*				697	10	–
266	Fixtures as at 1st July, 1935	2,100	–	–			
—	*Depreciation on Fixtures at 5 per cent*				105	–	–
S.L.	Sundry Trade Debtors	22,962	10	–			
272	Reserve for Bad Debts as at 1st July, 1935				920	3	8
—	*Additional Provision to Increase Bad Debt Reserve to £1,148 2s. 6d.*				227	18	10
273	Bills Receivable	15,498	–	–			
—	*Payments in Advance (Rent)*	48	–	–			
—	*Stock-in-trade—Finished*	9,242	7	7			
—	*Raw Material*	4,878	2	2			
B.L.	Sundry Creditors				24,409	7	3
—	*Expenses Accrued Due (Gas, etc.)*				72	8	8
290	Partners' Current Accounts—Strong	1,468	3	3			
291	Dawson	1,500	4	9			
292	Fenton	1,200	6	–			
—	*Interest on Partners' Capitals—Strong*				750	–	–
—	*Dawson*				750	–	–
—	*Fenton*				1,250	–	–
—	*Partners' Management Salaries—Strong*				750	–	–
	Dawson				375	–	
		£191,702	6	5	£191,702	6	5

STRONG, DAWSON, AND FENTON

Dr. **MANUFACTURING AND TRADING ACCOUNT FOR THE YEAR ENDED 30th JUNE, 1936** *Cr.*

		£	s.	d.			£	s.	d.
To Stock of Raw Material as at 1st July, 1935	√	5,902	6	8	By Stock of Raw Material as at 30th June, 1936	√	4,878	2	2
,, Purchases	√	25,692	3	3	,, Cost of Goods Manufactured during the year carried down		54,234	9	6
,, Wages	√	22,998	2	6					
,, Freight and Carriage	√	2,862	4	9					
,, Power	√	1,182	3	3					
,, Gas, Lighting, and Heating	√	475	11	3					
	£	59,112	11	8		£	59,112	11	8
To Stock of Finished Goods as at 1st July, 1935	√	7,989	4	8	By Sales	√	66,792	3	3
,, Manufactured Goods brought down		54,234	9	6	,, Stock of Finished Goods as at 30th June, 1936		9,242	7	7
,, Rent of Warehouse	√	108	9	2					
,, Gross Profit carried down		13,702	7	6					
	£	76,034	10	10		£	76,034	10	10

STRONG, DAWSON, AND FENTON

Dr. **PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 30th JUNE, 1936** *Cr.*

		£	s.	d.			£	s.	d.
To Salaries	√	3,789	2	6	By Gross Profit brought down		13,702	7	6
,, Rates	√	764	2	2	,, Discounts Received	√	330	2	3
,, Insurance	√	73	8	9					
,, Discounts Allowed	√	488	2	6					
,, Bad Debts written off	√	78	3	3					
,, Reserve for Bad Debts	√	227	18	10					
,, General Expenses	√	662	3	9					
,, Depreciation—									
Machinery at 7½ per cent per annum	√	697	10	–					
Fixtures at 5 per cent per annum	√	105	–	–					
,, Balance carried to Appropriation Account		7,146	18	–					
	£	14,032	9	9		£	14,032	9	9

STRONG, DAWSON, AND FENTON

Dr. **APPROPRIATION ACCOUNT FOR THE YEAR ENDED 30th JUNE, 1936** *Cr.*

	£	s.	d.		£	s.	d.
To Partners' Management Salaries—				By Balance from Profit and Loss Account	7,146	18	–
Strong	750	–	–				
Dawson	375	–	–				
„ Interest on Partners' Capital—							
Strong	750	–	–				
Dawson	750	–	–				
Fenton	1,250	–	–				
„ Profit Transferred to Partners' Current Accounts—							
Strong	1,635	19	–				
Dawson	1,090	12	8				
Fenton	545	6	4				
	£7,146	18	–		£7,146	18	–

BALANCE SHEET AS AT 30th JUNE, 1936

Liabilities	£	s.	d.	£	s.	d.	Assets	£	s.	d.	£	s.	d.
Bills Payable				25,104	2	9	Cash at Bankers				30,581	11	9
Sundry Creditors				24,409	7	3	Bills Receivable				15,498	–	–
Expenses Accrued Due				72	8	8	Sundry Trade Debtors	22,962	10	–			
Partners' Current Accounts—							*Less* Reserve	1,148	2	6			
Strong—Share of Profit	1,635	19	–								21,814	7	6
Salary	750	–	–				Payments in Advance				48	–	–
Interest on Capital	750	–	–				Stock-in-trade—						
	3,135	19	–				Finished Goods	9,242	7	7			
Less Drawings	1,468	3	3				Raw Material	4,878	2	2			
				1,667	15	9					14,120	9	9
Dawson—Share of Profit	1,090	12	8				Plant and Machinery	9,300	–	–			
Salary	375	–	–				*Less* Depreciation	697	10	–			
Interest on Capital	750	–	–					8,602	10	–			
	2,215	12	8				*Add* Additions	402	3	8			
Less Drawings	1,500	4	9								9,004	13	8
				715	7	11	Fixtures	2,100	–	–			
Fenton—Share of Profit	545	6	4				*Less* Depreciation	105	–	–			
Interest on Capital	1,250	–	–								1,995	–	–
	1,795	6	4				Freehold Land and Buildings				14,502	–	–
Less Drawings	1,200	6	–										
				595	–	4							
Partners' Capital Accounts—													
Strong	15,000	–	–										
Dawson	15,000	–	–										
Fenton	25,000	–	–										
				55,000	–	–							
				£107,564	2	8					£107,564	2	8

between manufacturing and trading. This procedure should be followed in the examination room if the question differentiates between stocks of raw material and stocks of finished goods. If the former are entered in a Manufacturing Account together with the usual manufacturing or factory charges, then the cost of the goods produced may be shown, as in the example.

The second point to be noted by students is that it may not be possible to adopt the special arrangement of the Trial Balance advocated in this volume, on account of the time limits imposed in examinations. The inclusion of reserves in the Trial Balance, and the arrangement of the various items in order, are matters of procedure which the student may not be able to adopt until he is called upon to prepare the actual accounts of an undertaking. The method is, therefore, a practical one rather than one which can be recommended for use in the examination room.

SELF-EXAMINATION QUESTIONS. XV

1. Give a list of the rules governing Partnership Accounts in the absence of express agreement.

2. What is meant by the Fixed Capital method in Partnership Accounts? What alternative method is there?

3. Give the Drawings Account of John Robertson as it would appear in the firm's private Ledger as on 31st December, under the following conditions—

His Capital on 1st January was £5,000.

His Drawings were: 1st May, £250; 1st July, £300; 1st November, £200; 1st December, £100.

His share of Profits for the year was £795.

Interest is allowed by the Partnership Deed on Capital and is charged on Drawings at 5 per cent per annum.—(*Royal Society of Arts.*)

4. A, B, C, and D contemplate entering into partnership in the textile trade and ask you to advise them generally, and to lay down a system of accounts with a view to your taking charge of the book-keeping and finance. State briefly what course you would adopt and what system you would lay down so that each partner's interests would be protected and the financial success of the business secured.—(*London Chamber of Commerce.*)

CHAPTER XVI

CHANGES IN PARTNERSHIP CONSTITUTION

THE principal changes in the constitution of partnerships which lead to important alterations in the books of account, are the following—

1. The retirement of a partner.
2. The admission of a new partner.
3. The dissolution of a partnership in which all partners are solvent.
4. The dissolution of a partnership on the insolvency of one or more partners.

The changes falling under Points 1 and 2 are dealt with in this present chapter, whilst the accounts relating to dissolution will be considered in Chapter XVII.

The Retirement of a Partner.

On retirement of a partner it is customary to arrange for the remaining partners to take over his interest. This may be effected either by the continuing partners paying to the retiring partner, out of their private resources, the amount due to him, or by making the payment out of the funds of the partnership. In the first case the only alterations to be made in the books consist of Journal entries transferring the balance on the retiring Partner's Account to the accounts of the continuing partners. In the second case the cash is paid out from the Partnership Banking Account and debited to the Capital Account of the retiring partner.

The two alternatives may be illustrated by the following examples based on the accounts of Strong, Dawson, and Fenton, which were also given in the last chapter.

EXAMPLE "A." Strong retired from the partnership on 1st July, 1936. All three partners first draw out

the amounts standing to their credit on Current Account. Dawson and Fenton then offer to take over Strong's interest in the partnership at book value, each paying him £7,500 out of their private resources. Strong agrees. Dawson and Fenton thereupon adjust their Balance Sheet, and enter into a new partnership in which they will share profits equally in future (see pages 203 and 204).

EXAMPLE "B." The retirement of Mr. Strong takes place on the same basis as in Example "A," but he withdraws his capital from the Partnership Banking Account instead of receiving it from Dawson and Fenton.

In this case there is no need to pass any entry through the Journal. A cheque for £15,000 is drawn and credited in the Cash Book, a corresponding debit being made to Strong's Capital Account. This cheque is, of course, paid to Strong in addition to the payment which has to be made in respect of his Current Account. The Balance Sheet, under this alternative method, appears on page 205.

Debt Due to Outgoing Partner.

The point which cannot fail to strike the student on examining the two examples illustrated on pages 203 to 205, is that the sudden call on the cash resources of Dawson and Fenton might easily prove embarrassing. Whether they have to provide the necessary £15,000 from their private resources, or whether it is paid out of the firm's account, it is a payment which might well cause considerable difficulty. This point is, in fact, a matter which does cause grave embarrassment in practice. To overcome the financial stringency it is customary to arrange for the amount due to a retiring partner to be treated as a debt or loan. Where such a course is possible, then the outgoing partner's Capital Account is transferred to "Loan Account" by journal entry.

DAWSON & FENTON (EXAMPLE "A").

JOURNAL

1935			£	s.	d.	£	s.	d.
July 1	Strong—Capital Account	*Dr.*	15,000	–	–			
	To Dawson—Capital Account					7,500	–	–
	,, Fenton—Capital Account					7,500	–	–
	Transfer of Mr. Strong's Capital Account under agreement dated ..... by which £15,000 is to be paid to him privately by Messrs. Dawson and Fenton.							

DAWSON AND FENTON

BALANCE SHEET AS AT 1st JULY, 1936

(After Giving Effect to the Arrangements under Example "A")

Liabilities	£	s.	d.	Assets	£	s.	d.
Bills Payable	25,104	2	9	Cash at Bankers	27,603	7	9
Sundry Creditors	24,409	7	3	Bills Receivable	15,498	–	–
Expenses Accrued Due	72	8	8	Sundry Trade Debtors	21,814	7	6
Partners' Capital Accounts—				Payments in Advance	48	–	–
Dawson	22,500	–	–	Stock-in-trade	14,120	9	9
Fenton	32,500	–	–	Plant and Machinery at cost	9,004	13	8
				Fixtures at cost	1,995	–	–
				Freehold Land and Buildings at cost	14,502	–	–
	£104,585	18	8		£104,585	18	8

Note. When comparing this Balance Sheet with that of Strong, Dawson, and Fenton on page 199, the difference in descriptions of fixed assets should be noted. They are now described as being taken "at cost," i.e. at cost to the new firm of Dawson and Fenton.

DAWSON AND FENTON

BALANCE SHEET AS AT 1st JULY, 1936

(After Giving Effect to the Arrangements under Example "B")

Liabilities	£	s.	d.	Assets	£	s.	d.
Bills Payable	25,104	2	9	Cash at Bankers	12,603	7	9
Sundry Creditors	24,409	7	3	Bills Receivable	15,498	–	–
Expenses Accrued Due	72	8	8	Sundry Trade Debtors	21,814	7	6
Partners' Capital Accounts—				Stock in Trade	14,120	9	9
Dawson	15,000	–	–	Payments in Advance	48	–	–
Fenton	25,000	–	–	Plant and Machinery at cost	9,004	13	8
				Fixtures at cost	1,995	–	–
				Freehold Land and Buildings at cost	14,502	–	–
	£89,585	18	8		£89,585	18	8

Interest at an agreed rate is then credited at specified intervals, and repayment is made in instalments agreed upon mutually between the continuing partners and the retiring member.

Repayment to Executors.

It is convenient at this stage to refer to the situation created by the decease of a partner. If, in the illustrations already given, Strong had died, then the amount due to him on 30th June, 1936, would have become a debt payable to his estate. The repayment of his capital would have followed the lines shown in Example "B." The cheque paid to his executors would amount to £16,667 15s. 9d., representing £15,000 capital, and £1,667 15s. 9d. balance of Current Account.

Policies of Survivorship.

As the death of a partner usually precludes the possibility of making an arrangement for treating his capital as a loan, the surviving partners are sometimes placed in an even more embarrassing situation than those discussed. The executors are often not in a position to allow time for repayment, and in certain cases they are forced to press for the repayment of the testator's capital. To meet such cases it is possible to take out, during the lifetime of the partners, survivorship insurance policies on the lives of the members, either jointly or severally. The premiums on these policies are charged to Profit and Loss Account. On the death of a partner the insurance company, by meeting the policy, furnishes the funds for repayment of the capital of the deceased member. This course is advantageous in that it causes no such financial stringency to the succeeding partnership as is involved in a sudden cash repayment out of trading assets.

The point to which attention must be drawn in connection with survivorship policies, is that the estate

of the deceased partner is entitled to an appropriate share in the proceeds of a policy. The share—which is calculated on the basis on which the deceased partner shared profits—must be credited to his account and handed over to the executors, together with any balances standing on his Capital or on his Current Accounts.

Goodwill.

In the examples we have considered in the preceding pages no account has been taken of goodwill. Strong, the retiring partner, was assumed to have agreed to repayment of his capital on book values only. He will doubtless stipulate, however, that he should receive a payment in respect of his share of goodwill. This asset would then have to be valued and brought into account. It might be calculated on the average of past profits, or on the value of patents not fully exploited, or on the potential value of other assets which may have been included in the Balance Sheet at amounts inferior to their real value. However the value of goodwill is arrived at, the subsequent procedure is the same. An Asset Account, " Goodwill," is opened and corresponding credits are made to the Capital Accounts of the partners in the proportions in which the profits are shared. A retiring partner—or the estate of a deceased partner—would then receive a cheque, not only for the balance standing on the original Capital Account, but also for his share of the goodwill.

The Admission of a Partner.

The admission of a new partner raises the matter of " Premium for Goodwill," which is sometimes paid on admission. This premium arises from the obligation of a new partner, in practically all cases, to pay for his share of the established goodwill. The existing partners are not usually willing for a new partner to introduce capital

on what may be referred to as " par terms," and they demand, as a rule, that he should pay a premium in addition. Compliance with this condition may be effected in more than one way. It may be arranged that the payment shall be made to the existing partners direct, or that it shall be adjusted in the accounts of the new firm.

Premium Paid Direct.

If the premium payable by an incoming partner is to be paid to the present partners direct, then no entries are made in the books beyond a debit in the Cash Book and a credit to the new partner's Capital Account in respect of the actual capital he introduces. The payment for his share of goodwill is made by means of cheques paid to the existing partners, and banked by them in their private banking accounts.

EXAMPLE. Johnson and Mason, who share profits in the proportion of 2 : 1, agree to admit Jameson on payment of £1,600 in respect of capital and £300 in respect of his share of goodwill. The premium of £300 is to be paid direct to the existing partners.

The *pro forma* Balance Sheets, set out on page 209, show the position of the partnership before and after the admission of Jameson.

Premium Retained in Business.

If the premium paid by an incoming partner is retained in the business, then the accounts affected will be " Cash at Bankers " and the Capital Accounts of the old partners.

EXAMPLE. Jameson is admitted to partnership on the terms set out in the preceding illustration, but the premium is to be retained in the business (see page 210).

If the illustration on page 210 is compared with the previous example, it will be seen that the goodwill

JOHNSON AND MASON

(*a*) BEFORE ADMISSION OF JAMESON

BALANCE SHEET AS AT .....

LIABILITIES	£	s.	d.	ASSETS	£	s.	d.
Sundry Creditors	3,000	–	–	Cash at Bankers	2,000	–	–
Partners' Capital Accounts—				Sundry Debtors	2,000	–	–
Johnson	2,000	–	–	Freehold Land	2,000	–	–
Mason	1,000	–	–				
	£6,000	–	–		£6,000	–	–

JOHNSON, MASON, AND JAMESON

(*b*) AFTER ADMISSION OF JAMESON

BALANCE SHEET AS AT .....

LIABILITIES	£	s.	d.	ASSETS	£	s.	d.
Sundry Creditors	3,000	–	–	Cash at Bankers	3,600	–	–
Partners' Capital Accounts—				Sundry Debtors	2,000	–	–
Johnson	2,000	–	–	Freehold Land	2,000	–	–
Mason	1,000	–	–				
Jameson	1,600	–	–				
	£7,600	–	–		£7,600	–	–

JOHNSON, MASON, AND JAMESON

AFTER ADMISSION OF JAMESON

BALANCE SHEET AS AT .....

LIABILITIES	£	s.	d.	ASSETS	£	s.	d.
Sundry Creditors	3,000	–	–	Cash at Bankers	3,900	–	–
Partners' Capital Accounts—				Sundry Debtors	2,000	–	–
Johnson	2,200	–	–	Freehold Land	2,000	–	–
Mason	1,100	–	–				
Jameson	1,600	–	–				
	£7,900	–	–		£7,900	–	–

proportion of the cash introduced by Jameson has been treated in the following way—

	Original Capital	Goodwill Credited	Total
	£	£	£
Johnson . . .	2,000	200	2,200
Mason . . .	1,000	100	1,100

Johnson is credited with £200 and Mason with £100, because they share profits in the proportion of two-thirds and one-third.

Premium Withdrawn.

There is an alternative method which differs very slightly from the two which we have just considered. It is sometimes arranged that the cash paid by an incoming partner in respect of goodwill shall be brought into the firm's books and immediately withdrawn. The only advantage which can be claimed for this method is that it is a permanent record of the total cash paid by the new partner. The Balance Sheet of Johnson and Mason, under this scheme, would first take the form of the illustration given on page 210. Then on the withdrawal of £300 by the original partners, the Balance Sheet would be identical with the example given in the lower portion of page 209.

Goodwill Account.

The close attention of the student reader is now drawn to the fact that no "Goodwill Account" appeared in the illustrations relating to the admission of Jameson; this is correct, for each of the examples given was based on a cash payment by the incoming partner for his share of goodwill. Whenever the premium is paid in cash there is no necessity to raise a Goodwill Account. If, however, the incoming partner

is called upon to subscribe the amount of his proposed capital in cash, and to bear his contribution towards goodwill " in account," then the raising of " Goodwill Account " results.

The reason for opening a Goodwill Account will become perfectly clear if the corresponding credit entry is considered. Goodwill Account is debited and the Capital Accounts of the old partners are credited in the proportions in which they share profits. The effect is to give them a proportionately greater claim to the net assets than they would have if an incoming partner were admitted on " par terms."

EXAMPLE. Johnson and Mason are in partnership under the circumstances set out on page 208. They agree to admit Jameson on the conditions that he subscribes £1,600 in respect of his capital. The goodwill is to be valued at £2,100. The future profits are to be divided in the proportions: Johnson $\frac{1}{7}$ (instead of $\frac{2}{3}$), Mason $\frac{2}{7}$ (instead of $\frac{1}{3}$), and Jameson $\frac{1}{7}$. No cash is payable by Jameson in respect of goodwill.

The Balance Sheets illustrating this example are given on page 213.

Goodwill Share on Loan.

Admissions to partnerships are occasionally arranged on the basis that the incoming partner's share of goodwill shall be treated as a loan due from him to the firm. In such a case he is allowed, as a rule, to repay the loan gradually out of his share of future profits. In other cases his share of goodwill is written off against Profit and Loss Account in such a way that the former partners are not charged with any share of such writing-down. This entails a temporary readjustment of the ratios in which profits are shared.

We do not give illustrations or detailed explanations of these advanced partnership accounts as the secretary is scarcely likely to encounter them. The reader

JOHNSON AND MASON

(*a*) Before Admission of Jameson

BALANCE SHEET AS AT .....

Liabilities	£	s.	d.	Assets	£	s.	d.
Sundry Creditors	3,000	–	–	Cash at Bankers	2,000	–	–
Partners' Capital Accounts—				Sundry Debtors	2,000	–	–
Johnson	2,000	–	–	Freehold Land	2,000	–	–
Mason	1,000	–	–				
	£6,000	–	–		£6,000	–	–

JOHNSON, MASON, AND JAMESON

(*b*) After Admission of Jameson

BALANCE SHEET AS AT .....

Liabilities	£	s.	d.	Assets	£	s.	d.
Sundry Creditors	3,000	–	–	Cash at Bankers	3,600	–	–
Partners' Capital Accounts—				Sundry Debtors	2,000	–	–
Johnson	3,400	–	–	Freehold Land	2,000	–	–
Mason	1,700	–	–	Goodwill	2,100	–	–
Jameson	1,600	–	–				
	£9,700	–	–		£9,700	–	–

who is interested in these problems may, with profit, refer to Pitman's *Partnership Law and Accounts.*

Adjustment of Assets.

Occasionally an incoming partner is required to agree to a revaluation of assets before he is admitted. This stipulation is quite reasonable if the assets have been written down excessively, or if they are of a greater value than that at which they are shown in the accounts. The method of dealing with this point is to debit the assets concerned with the amount of the appreciation, and to credit an "Assets Revaluation Account." This account is then closed by transferring it to the accounts of the old partners in the appropriate proportions.

SELF-EXAMINATION QUESTIONS. XVI

1. What procedure is followed on the retirement of a partner? Explain the uses served by a survivorship insurance policy.
2. What is Goodwill? Set out the circumstances under which a Goodwill Account is opened in partnership books.
3. What are the different methods of dealing with a premium paid by an incoming partner on admission to a partnership?
4. White is admitted to partnership with Black and Brown. He is required to pay a premium of £1,500, which is to be left in the business as working capital. His capital is to be £4,000, also introduced in cash. Black's capital is £5,000 and Brown's £4,380. They share profits equally. Set out the new firm's Balance Sheet on the assumption that the creditors amounted to £10,620, cash at bank (before White's admission) £2,300, plant £4,700, stock £5,000, and debtors £8,000.
5. In the circumstances given in Question 4, but assuming that White's premium is to be withdrawn by Black and Brown, what procedure will be followed?

CHAPTER XVII

PARTNERSHIP DISSOLUTIONS

THE dissolution of partnerships affords a further example of a type of accounts lending itself to rules of procedure. In accordance with our practice, however, we again ignore these rules for the present and devote our attention to the principles upon which Dissolution Accounts are based.

Dissolution of Solvent Partnerships.

In recording the dissolution of partnerships in which all partners are solvent, it is first necessary to set down any arrangements which the partners make among themselves for the distribution of the assets. If it is arranged that one or more partners shall purchase the business and continue to trade, then the Dissolution Accounts are no different from those recording an ordinary retirement of a partner or partners. These accounts, it will be recalled, were explained in the preceding chapter. If the partners arrange that the business be wound up entirely, then a different procedure is followed.

Sale of Assets.

On a dissolution entailing a sale of assets, the natural procedure—irrespective of accountancy rules—would be to debit the Cash Book with the proceeds of the sale of the plant, the fixtures, the leases, etc. The corresponding credits would then be made to the respective Asset Accounts. Similarly, the cash collected from the debtors would be posted to the Sales Ledgers, and the cash paid to the creditors would be posted to the Bought Ledgers.

At the end of the process the partners would probably—indeed, certainly—find that although all the

liabilities had been met, and that all the assets had been realized as far as possible, balances remained standing on certain of the accounts. A little reflection serves to show that if these balances are credit balances, then —apart from the Partners' Accounts—they must represent profits arising from the sale of assets, or from savings in the satisfying of creditors. If, on the other hand, the balances are debit balances, then—apart from the cash at bank—they can only represent losses arising on realization of assets, including bad debts, or arising from the payment of liabilities in excess of those which were believed to be due.

Disposal of Balances.

Still following the normal or natural procedure, regardless of fixed accountancy rules, the partners would apportion between themselves the balances standing on the various accounts in the proportions in which they share profits and losses. Any partner whose account was overdrawn would then pay in the amount of his debt to the firm. Lastly, the cash at bank would be divided according to the balance standing to the credit of each Partner's Account, and it needs no great reflection to perceive that the amount of cash available would be sufficient to close, exactly, the account of each partner.

Rules for Dissolution of Solvent Partnerships.

Having examined the method which partners would normally adopt for securing the equitable division of the net assets, we may now consider the usual method followed by the accountant. The method is naturally designed to save time, and for that reason is likely to bewilder the student unless he has first had explained to him the principles set out in the preceding paragraphs.

The accepted method follows these rules—

1. All accounts except Cash, Partners' Accounts, Creditors' Accounts, and Debtors' Accounts are transferred to "Realization Account."

2. Cash received or paid out in respect of the assets and liabilities transferred to Realization Account are entered in the Cash Book, and then posted to "Realization Account."

3. Payments to creditors are credited in the Cash Book and debited to the creditors concerned.

4. Collections from debtors are debited in the Cash Book and credited to the accounts of the debtors.

5. The accounts of debtors who fail to pay and whose accounts must, therefore, be regarded as bad are transferred, by Journal, to the debit of "Realization Account."

6. Discounts received or similar profits arising on the settlement with creditors are transferred, by Journal, to the credit of "Realization Account."

7. The agreed value of assets taken over by individual partners is credited to "Realization Account" and debited to the accounts of the partners concerned.

8. The net balance on "Realization Account" is then divided between the partners in the proportions in which they share profits and losses. If the Realization Account shows a debit balance (a net loss on realization), then the accounts of the partners are debited. If a profit has been made on realization, then each partner is credited with his proportion.

9. Any balances which may be due from partners are then paid in by such partners, in cash.

10. Loans advanced by partners are next repaid, cash being credited and the Loan Accounts being debited, or the amounts due are added to the partner's Capital Accounts.

11. The balance of the cash is then distributed among

the partners according to the balance standing to the credit of each.

The example set out below illustrates the application of these rules.

Jenkins, Mainwaring, and Webster share profits in the proportions 5 : 3 : 1. They decide to dissolve partnership and to wind up their business and they take out the rough Balance Sheet, shown on page 219, for the purpose.

During the realization Jenkins agrees to buy the lease for £6,000. The debts are all collected except £123 8s. 8d., which proves to be bad. The Stock realizes £2,929. The Plant is sold by auction for £2,002 12s. 11d. net. An amount of £75 2s. 9d. is found not to be due to one of the creditors. The Incidental Expenses of realization amount to £100 (see pages 220, 221, and 222).

The Account of an Insolvent Partner.

We now proceed to examine the situation which arises if one of the partners is insolvent on dissolution. Prior to 1903 it was the custom to treat the deficiency on the insolvent Partners' Account as an ordinary loss. This meant that it was shared by the solvent partners in the proportions in which they shared profits and losses. In November, 1903, the decision in the case of *Garner* v. *Murray* brought about an alteration, and such losses are now shared by the solvent partners in proportion to their last agreed capitals.

The decision requires that the solvent partners shall "make good" the deficiency which arises. There is some little doubt as to the exact meaning of the words "make good." Most accountants take them to mean that the solvent partners shall bring in cash to meet the deficiency; others hold that it is only necessary to make appropriate adjustments in the Partners' Accounts. The point is not of great importance, for

JENKINS, MAINWARING, AND WEBSTER

BALANCE SHEET AS AT 31st DECEMBER, 1933

Liabilities	£	s.	d.	Assets	£	s.	d.
Bills Payable	1,942	6	8	Cash at Bank	4,011	2	8
Creditors	4,322	9	8	Debtors	2,892	3	7
Jenkins—Loan Account	2,000	–	–	Stock-in-trade	3,100	4	8
Partners' Capital Accounts—				Plant and Machinery	1,982	6	6
Jenkins	5,223	6	3	Leasehold Premises	4,791	15	10
Mainwaring	4,289	10	8	Partners' Capital Account Overdrawn—			
				Webster	1,000	–	–
£	17,777	13	3	£	17,777	13	3

JENKINS, MAINWARING, AND WEBSTER

REALIZATION ACCOUNT

Dr. *Cr.*

1934			£	s.	d.	1934			£	s.	d.
Jan. 1–31	To Assets Transferred—					Jan. 1–31	By Transfer from Bought Ledger Control, amount found not to be due to Creditor	Jnl.	75	2	9
	Stock-in-trade	Jnl.	3,100	4	8						
	Plant and Machinery	Jnl.	1,982	6	6						
	Leasehold Premises	Jnl.	4,791	15	10						
,, 1–31	,, Transfer from Sales Ledger Control, amount of Bad Debts	Jnl.	123	8	8	,, 1–31	,, Transfer of Agreed Value of Lease to Jenkins' Account	Jnl.	6,000	–	–
,, 1–31	,, Cash—Expenses of Realization	C.B.	100	–	–	,, 1–31	,, Cash Received on Sale of Stock	C.B.	2,929	–	–
,, 1–31	,, Transfer of Profit on Realization to Partner's Capital Accounts—					,, 1–31	,, Cash Received on Sale of Plant and Machinery	C.B.	2,002	12	11
	Jenkins	Jnl.	505	–	–						
	Mainwaring	Jnl.	303	–	–						
	Webster	Jnl.	101	–	–						
		£	11,006	15	8			£	11,006	15	8

Dr. **JENKINS—CAPITAL ACCOUNT** *Cr.*

1934			£	s.	d.	1934			£	s.	d.
Jan. 1–31	To Agreed Value of Lease taken over	Jnl.	6,000	–	–	Jan. 1	By Balance b/f		5,223	6	3
,, 1–31	,, Cash (amount received at close of Realization)	C.B.	1,728	6	3	,, 1	,, Transfer of Balance from Loan Account	Jnl.	2,000	–	–
						,, 1–31	,, Share of Profit transferred from Realization Account	Jnl.	505	–	–
			£7,728	6	3				£7,728	6	3

Dr. **MAINWARING—CAPITAL ACCOUNT** *Cr.*

1934			£	s.	d.	1934			£	s.	d.
Jan. 1–31	To Cash (amount received at close of Realization)	C.B.	4,592	10	8	Jan. 1	By Balance b/f		4,289	10	8
						,, 1–31	,, Share of Profit transferred from Realization Account	Jnl.	303	–	–
			£4,592	10	8				£4,592	10	8

Dr. **WEBSTER—CAPITAL ACCOUNT** *Cr.*

1934		£	s.	d.	1934			£	s.	d.
Jan. 1	To Balance Overdrawn at this date . . . b/f	1,000	–	–	Jan. 1–31	By Share of Profit transferred from Realization Account . . .	Jnl.	101	–	–
					,, 1–31	,, Cash Introduced (at close of Realization) . .	C.B.	899	–	–
		£1,000	–	–				£1,000	–	–

Dr. **CASH BOOK** *Cr.*

1934			£	s.	d.	1934				£	s.	d.
Jan. 1	To Balance at this date b/f		4,011	2	8	Jan. 1–31	By Payments to Creditors .	B.L.		4,247	6	11
,, 1–31	,, Cash received in respect of Stock . . .	P.L.	2,929	–	–	,, 1–31	,, Payments in respect of Bills Payable . .	P.L.		1,942	6	8
,, 1–31	,, Cash received in respect of Plant and Machinery .	P.L.	2,002	12	11	,, 1–31	,, Expenses of Realization .	P.L.		100	–	–
,, 1–31	,, Cash received from Debtors	S.L.	2,768	14	11	,, 1–31	,, Payments to Partners— Jenkins . . .	P.L.		1,728	6	3
,, 1–31	,, Cash introduced by Webster	P.L.	899	–	–		Mainwaring . .	P.L.		4,592	10	8
		£	12,610	10	6			£		12,610	10	6

the result is exactly the same. The introduction of cash has this to recommend it—it does fulfil the letter as well as the spirit of the decision in *Garner* v. *Murray*. It is the version which is adopted below.

The important matter for the student to grasp is the difference in treatment of deficiencies which the case of *Garner* v. *Murray* brought about. In order to show the effect of the decision, two examples are given on pages 224 and 225. In the first—marked "A"—a loss arising on a partner's insolvency is divided in the way it would have been apportioned prior to *Garner* v. *Murray*. In the second—marked "B"—the division follows present practice. Both examples are based on the accounts of Jenkins, Mainwaring, and Webster, used in the preceding illustration. Webster, whose account, it will be remembered, was overdrawn, is now assumed to be insolvent.

Purchase of a Partnership Business.

The final matter to be dealt with under the heading of "Partnership" is the acquisition of a firm's business by a company. The entries to be made are extremely simple. In the books of the firm a "Realization Account" is opened, as previously described. To this account is posted the purchase price received from the company, and profit or loss being transferred to the Partners' Accounts in the usual way. The cash at the bank is then used to pay each partner the amount shown to his credit, and the books are finally closed off. For purposes of convenience it is generally arranged, in cases such as the foregoing, for the partnership to retain any cash which may be in the firm's Banking Account, the purchase price being reduced by a corresponding amount. The only advantage gained by this adjustment is that a needless exchange of cheques is obviated.

It must be borne in mind that the purchase price payable by a company for a partnership business will

EXAMPLE "A." PRIOR TO *Garner* v. *Murray*

BALANCE SHEET (BEFORE FINAL SETTLEMENT)

LIABILITIES	£	s.	d.	ASSETS	£	s.	d.
Partners' Capital Accounts—				Cash at Bankers	5,421	16	11
Jenkins	1,728	6	3	Partners' Capital Account—Webster (overdrawn and insolvent)	899	–	–
Mainwaring	4,592	10	8				
	£6,320	16	11		£6,320	16	11

BALANCE SHEET (AFTER FINAL SETTLEMENT)

LIABILITIES	£	s.	d.	£	s.	d.	ASSETS	£	s.	d.
Partners' Capital Accounts—							Cash at Bankers	5,421	16	11
Jenkins	1,728	6	3							
Less $\frac{5}{8}$ of Webster's Deficiency	561	17	6	1,166	8	9				
Mainwaring	4,592	10	8							
Less $\frac{3}{8}$ of Webster's Deficiency	337	2	6	4,255	8	2				
				£5,421	16	11		£5,421	16	11

Note. The partners shared profits in the proportions of 5 : 3 : 1 ; the proportion between Jenkins and Mainwaring is therefore 5 : 3, or $\frac{5}{8}$ and $\frac{3}{8}$.

EXAMPLE "B." After *Garner* v. *Murray*

Liabilities	£	s.	d.	£	s.	d.	Assets	£	s.	d.	£	s.	d.
Partners' Capital Accounts—							Cash at Bankers	5,421	16	11			
Jenkins	5,223	6	3				*Add* Cash introduced—						
Less Adjustment on Realization							Jenkins, $\frac{5223}{9812}$ of £899	493	12	9			
Mainwaring	3,495	0	0				Mainwaring, $\frac{4589}{9812}$ of £899	405	7	3			
				1,728	6	3					6,320	16	11
	4,289	10	8										
Add Adjustment on Realization	303	0	0										
				4,592	10	8							
				£6,320	16	11					£6,320	16	11

Note. The apportionment is made on the basis of the last agreed balances on Capital Accounts and not on the Capital Accounts as adjusted by profits or losses on realization.

WILLIAMS AND TERRY
BALANCE SHEET AS AT 1st JANUARY, 193..

Liabilities	£	s.	d.	Assets	£	s.	d.
Creditors	14,282	3	8	Cash at Bankers	202	9	8
Partners' Capital Accounts—				Bills Receivable	8,298	6	6
Williams	23,239	4	6	Stock-in-trade	14,388	2	10
Terry	22,288	3	7	Debtors	3,140	2	8
				Plant and Machinery	10,289	2	3
				Fixtures	4,220	1	11
				Freehold Land and Buildings	19,271	5	11
£	59,809	11	9	£	59,809	11	9

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JOURNAL

Date 1935			£	s.	d.	£	s.	d.
Jan. 1	Sundries	*Dr.*						
	Cash at Bankers		202	9	8			
	Bills Receivable		8,298	6	6			
	Stock-in-trade		14,388	2	10			
	Debtors		3,140	2	8			
	Plant and Machinery		10,289	2	3			
	Fixtures		4,220	1	11			
	Freehold Land and Buildings		19,271	5	11			
	Goodwill		4,472	11	11			
	To Sundries—							
	Creditors					14,282	3	8
	Mr. Williams and Mr. Terry					50,000	–	–
			£64,282	3	8	£64,282	3	8

(Here follows a narrative setting out appropriate references to the purchase agreement and to the Board Minute approving the purchase.)

not always correspond to the book value of the net assets. The partners may demand a payment in respect of goodwill. In this case the company's secretary journalizes the assets and liabilities taken over, and debits the difference between the net assets and the purchase price to "Goodwill Account."

EXAMPLE. The Unicorn Co., Ltd., purchases on 1st January, 1935, the business of Williams and Terry for £50,000 in cash. The Balance Sheet of the firm set out at the foot of page 225 shows the position, and the journal entry, given on page 226, illustrates the treatment of the assets—including goodwill—by the secretary of Unicorn Co,, Ltd.

SELF-EXAMINATION QUESTIONS. XVII

1. Black and White have been in business for three years ending 31st December, and at that date agree to dissolve partnership. Black takes over the business and pays White £1,800 for his share of Goodwill. Black has drawn out £500 each year and White £650 each year. Black's Capital at the start was £3,000 and White's £4,000. The profits of each year were £1,000, £1,200, and £1,350 respectively. There was no deed of partnership and no arrangement as to Interest on Capital. Draft the Capital Accounts, show the amount which White will receive, and give the Profit and Loss Account in Black and White's books, and the Goodwill Account in Black's books.—(*National Union of Teachers.*)

2. Submit a formula for dealing in the books with an ordinary dissolution of partnership.

3. Explain briefly the *Garner* v. *Murray* decision and the consequent treatment of accounts in the books.

4. X, Y, and Z dissolve partnership and, after realization, find the following position of affairs—

BALANCE SHEET

LIABILITIES	£	ASSETS	£
Creditors	464	Cash at Bank	11,550
Capital Accounts—		Z—Capital Account overdrawn .	434
X . .	6,000		
Y . .	5,000		
Profit on Realization . .	520		
	£11,984		£11,984

The partners share profits and losses as follows: X, $\frac{1}{2}$; Y, $\frac{3}{10}$; and Z, $\frac{1}{5}$. Z is unable to contribute anything. Draw up the final accounts.

CHAPTER XVIII

ROYALTY ACCOUNTS

A ROYALTY is a payment made by a user of property to the owner for the privilege of dealing with the property for the user's benefit. Thus a publisher pays a royalty to an author, a quarrying company pays a royalty to quarry owners, and a coal mining company pays a royalty to the owner of the land under which the coal is situated.

Royalties are usually based on a fixed sum per unit, e.g. per ton of coal mined or per ton of stone quarried. The fixed sum is, however, usually stipulated to be subject to certain conditions. These conditions have for their object the adjustment of the respective interests of owner and user, should the fixing of a definite royalty prove harsh to one or the other under given circumstances.

The Royalty Agreement.

The secretary who is called upon to record the payment of royalties will have before him an agreement setting out the amount of the royalty per unit and the conditions, if any, attaching to the payment.

He is then recommended to adopt a course which has been found of great benefit in practice. It consists of the preparation of a key to the accountancy work contained in the various clauses of the Royalty Agreement.

The key is then preserved for reference purpose and may, if desired, be made available to the secretary's staff when they make any necessary entries in the royalty accounts.

The first step to take is to set out, in tabulated order,

the various conditions and clauses. Each point should then be examined separately and the twofold aspect of each accounting entry which is involved should be noted carefully. Finally, the debits should be set down on a sheet of analysis paper, one column being devoted to each year. Immediately underneath should be listed the various corresponding credits. The object of this procedure is to settle the names of the accounts to be opened in the books and to provide a key to which reference may be made as each year's royalties become payable. Needless to say, the figures entered in the key-statements will be imaginary only, the actual figures being entered in the Ledger as and when they arise.

Coal Mining Royalties.

In order to illustrate the procedure advocated above, we will first examine an extremely simple case in which no conditions have been imposed. We are informed that the Zephyr Coal Mining Co., Ltd., has entered into an agreement with Sir John Blank for a four years' lease of the Zephyr Mines on a royalty basis of 1s. per ton of coal raised.

The tabulations in this case could be dispensed with, but we adhere to the procedure in order that the next illustrations may be more easily followed. The secretary assumes, for the purposes of his key, that the coal to be raised during the four years will be 6,000 tons, 8,000 tons, 12,000 tons, and 20,000 tons.

(*a*) Accountancy Entries to Record the Conditions.

1. The landlord must be credited with 1s. per ton on the coal raised each year.

2. A debit to "Royalties Account" must be made in each year corresponding to the credit made under 1.

(*b*) Key to the Double Entry Applicable to the Conditions.

DEBITS

Accounts	Year 1	Year 2	Year 3	Year 4
Royalties Account	£ 300	£ 400	£ 600	£ 1,000
	£300	£400	£600	£1,000

(*Note.*—The debit to Profit and Loss Account would be "To Royalties" equal to the amounts shown above for each of the respective years.)

CREDITS

Accounts	Year 1	Year 2	Year 3	Year 4
Landlord's Account (Sir John Blank)	£ 300	£ 400	£ 600	£ 1,000
	£300	£400	£600	£1,000

(*Note.*—The Landlord's Account would be closed, on payment, by crediting cash and debiting the Landlord's Account.)

Minimum Rental.

The next example to be studied introduces two conditions which the secretary will almost certainly encounter in any royalty agreements entered into by his company. The landlord generally stipulates that, whilst he will be content with a rental calculated on a royalty basis, he must insist that in years in which there is little or no production he must yet receive a minimum rental. This minimum rent is known by various names, e.g. Fixed Rent, Minimum Rent, Dead Rent, etc.

Short Workings Recoverable.

As a set-off against the payment of a dead rent, the lessees stipulate that a condition in their favour shall be inserted. They claim that as their production in the first year or two is likely to be very small, they should be allowed to carry forward the difference between the small amount of royalties they would have paid and the dead rent insisted upon by the landlord. When the royalties exceed the dead rent, then, say the lessees, they should be allowed to recover the differences which they have been carrying forward on what is known as "Short Workings Recoverable Account." The landlord usually agrees to this condition, but with a time limit of, say, one or two years. The recovery of short workings is, of course, only obtained to the extent of royalties in excess of dead rent; in other words, the landlord, whilst permitting a deduction from his royalties never agrees to make a refund in cash.

To illustrate the process of tabulating an agreement containing dead rent and short workings recovery clauses, we will take again the case of the Zephyr mine. In this instance we will assume that the landlord insists on a dead rent of £500 per annum, but in return agrees to allow recovery of short workings up to the end of the third year of the lease.

(*a*) ACCOUNTANCY ENTRIES TO RECORD THE CONDITIONS.

1. The landlord must be credited with £500 per annum at least, the corresponding debit being made partly to royalties and partly to short workings recoverable during the years in which the royalties are less than the dead rent and within the period in which recovery is possible.

2. When the royalties exceed the dead rent and previous shortcomings are recoverable, then royalties will be debited in full, but the corresponding credits will be made partly to the landlord and partly to short workings recoverable.

3. "Short Workings Recoverable" will be carried forward as an asset during the period in which they are recoverable. Any portion unrecovered at the expiration of the time limit will be written off as a charge against Profit and Loss Account.

(*b*) KEY TO THE DOUBLE ENTRY APPLICABLE TO THE CONDITIONS.

(See tables on page 233).

Variations of Method.

At this point the student is informed that the tabulations given above and, of course, the actual entries in the Ledger must not be regarded as invariable. On the contrary, the secretary may prepare his précis in his own way, provided it deals with every salient clause in the agreement. The key which he prepares will then follow his own précis and, in all probability, will differ slightly from those given above. This latitude tends to make the practical work of recording royalties a simple matter, provided always that the meaning and effect of each particular agreement are first thoroughly understood. It is useless for the secretary to attempt

(*b*) Key to the Double Entry Applicable to the Conditions.

DEBITS

	Year 1	Year 2	Year 3	Year 4
	£	£	£	£
Royalties	300	400	600	1,000
Short Workings Recoverable	200	100	—	—
Profit and Loss Account (Short Workings unrecovered written off)	—	—	—	200
	£500	£500	£600	£1,200

CREDITS

	Year 1	Year 2	Year 3	Year 4
	£	£	£	£
Landlord	500	500	500	1,000
Short Workings—				
Recovered	—	—	100	—
Irrecoverable and written off to Profit and Loss	—	—	—	200
	£500	£500	£600	£1,200

to deal with these accounts by following stereotyped rules, the meaning of which he does not appreciate.

In order to demonstrate that variations in the preparation of the précis have no effect on the result, we will assume that the example given above falls to be recorded by a secretary whose tabulation of points differs from ours.

(*a*) ACCOUNTANCY ENTRIES TO RECORD THE CONDITIONS.

1. The landlord must be credited with an amount equal at least to the dead rent, and Dead Rent Account must be debited with a similar amount whenever the royalties are less than the minimum rent.

2. The actual royalties must be debited to Royalties Account and credited to Dead Rent Account in the years in which they are less than the minimum rent, the balance on dead rent being transferred to "Short Workings Account."

3. In the years in which the royalties exceed the minimum rent they must be debited to Royalties Account, and credited partly to the landlord and partly to short workings, provided recovery is still possible.

(*b*) KEY TO THE DOUBLE ENTRY APPLICABLE TO THE CONDITIONS.

(See tables on page 235).

Royalties Accounts in Ledger.

As mentioned in the early part of the chapter, it is impossible for the secretary to forecast the actual entries which he will make in his books until the results of each year's working under the royalty agreement are known. All he can do is to keep his précis and key before him, and apply them to the actual figures of each year as they become available.

(*b*) Key to the Double Entry Applicable to the Conditions.

DEBITS

	Year 1	Year 2	Year 3	Year 4
	£	£	£	£
Dead Rent Account	500	500	—	—
Royalties	300	400	600	1,000
Short Workings Account (transfers from Dead Rent Account)	200	100	—	—
Profit and Loss (Short Workings unrecovered written off)	—	—	—	200
	£1,000	£1,000	£600	£1,200

CREDITS

	Year 1	Year 2	Year 3	Year 4
	£	£	£	£
Landlord	500	500	500	1,000
Dead Rent Account (amount of the Royalties)	300	400	—	—
Dead Rent Account (transfers to Short Workings Account)	200	100	—	—
Short Workings—				
Recovered	—	—	100	—
Irrecoverable and written off to Profit and Loss	—	—	—	200
	£1,000	£1,000	£600	£1,200

The student who is called upon to deal with Royalty Accounts in an examination room is in a different position. He will be given the figures for each of the years and will be called upon to produce Ledger Accounts for the whole period. For his benefit therefore we will set out a final example in which the actual entries in the Ledger Accounts are given.

EXAMPLE. The Northern and Southern Quarry Co., Ltd., leases a quarry from James & Son at a royalty of 6d. per ton of mineral. There is a dead rent of £650 per annum, but short workings may be recovered up to the end of the fourth year. The tonnage raised during the first four years is 10,480, 24,920, 35,760, and 78,240 tons. It is required to show the Ledger Accounts over that period. (See pages 237, 238, and 239.)

Examination Practice.

The examination student will find that he is afforded excellent practice if he works the foregoing example back to a précis and a key. During this process it is quite possible that he may find further variations in the method of recording the given entries. If he succeeds in drawing up alternative methods, he should note them carefully for revision purposes later. There is one point which he should bear in mind during this work: care should be taken to avoid methods which give effect—even temporarily—to entries which are theoretically incorrect. For example, it is possible to record recovery of short workings by crediting a Landlord's Account with gross royalties and then immediately debiting it with a transfer from Short Workings Recoverable. This entails treating the landlord as a creditor for a larger amount than he is entitled to, and for this reason these and similar entries should be avoided.

NORTHERN AND SOUTHERN QUARRY CO., LTD.

Dr. **LANDLORDS' ACCOUNT (James & Son)** *Cr.*

Year			£	s.	d.	Year			£	s.	d.
1	To Cash	C.B.	650	–	–	1	By Dead Rent	Jnl.	650	–	–
2	,, Cash	C.B.	650	–	–	2	,, Dead Rent	Jnl.	650	–	–
3	,, Cash	C.B.	650	–	–	3	,, Royalties	Jnl.	650	–	–
4	,, Cash	C.B.	1,785	–	–	4	,, Royalties	Jnl.	1,785	–	–

Dr. **ROYALTIES** *Cr.*

Year			£	s.	d.	Year			£	s.	d.
1	To 6d. per ton on 10,480 tons	Jnl.	262	–	–	1	By Profit and Loss Account	Jnl.	262	–	–
2	,, 6d. per ton on 24,920 tons	Jnl.	623	–	–	2	,, Profit and Loss Account	Jnl.	623	–	–
3	,, 6d. per ton on 35,760 tons	Jnl.	894	–	–	3	,, Profit and Loss Account	Jnl.	894	–	–
4	,, 6d. per ton on 78,240 tons	Jnl.	1,956	–	–	4	,, Profit and Loss Account	Jnl.	1,956	–	–

NORTHERN AND SOUTHERN QUARRY CO., LTD.

DEAD RENT ACCOUNT

Dr. *Cr.*

Year			£	s.	d.	Year			£	s.	d.
1	To Landlord's Minimum Rental	Jnl.	650	–	–	1	By Royalties	Jnl.	262	–	–
							,, Transfer to Short Workings Recoverable Account	Jnl.	388	–	–
			£650	–	–				£650	–	–
2	To Landlord's Minimum Rental	Jnl.	650	–	–	2	By Royalties	Jnl.	623	–	–
							,, Transfer to Short Workings Recoverable Account	Jnl.	27	–	–
			£650	–	–				£650	–	–

NORTHERN AND SOUTHERN QUARRY CO., LTD.

Dr. SHORT WORKINGS RECOVERABLE ACCOUNT *Cr.*

Year			£	s.	d.	Year			£	s.	d.
1	To Transfer from Dead Rent A/c	Jn.	388	–	–	1	By Balance c/d		388	–	–
			£388	–	–				£388	–	–
2	To Balance b/d		388	–	–	2	By Balance	c/d	415	–	–
	,, Transfer from Dead Rent A/c	Jnl.	27	–	–						
			£415	–	–				£415	–	–
3	To Balance b/d		415	–	–	3	By Royalties Account (amount recovered)	Jnl.	244	–	–
							,, Balance c/d		171	–	–
			£415	–	–				£415	–	–
4	To Balance b/d		171	–	–	4	By Royalties Account (amount recovered)	Jnl.	171	–	–
			£171	–	–				£171	–	–

SELF-EXAMINATION QUESTIONS. XVIII

1. What is meant by "Royalty," "Dead Rent," and "Short Workings?"

2. Set out a practical procedure for dealing with a Royalty Agreement containing a dead rent clause and a recovery clause expiring at the end of the third year of a term of twenty years.

3. The Z Co. leases a quarry to the M Co. for ten years at a royalty of 1s. per ton. The output for the first four years is 5,022, 10,984, 3,270, and 20,400 tons. There is a dead rent of £500 per annum, but short workings are recoverable to the end of the fourth year. Set out the accounts in the books of the M Co., Ltd.

4. The Colliery Owning Co., Ltd., leases its main colliery to the Z Y Co., Ltd., for twenty years at a rental of 1s. per ton on the first 10,000 tons of each year's production and 6d. per ton on all excess production. There is a minimum rental of £300. Short workings are recoverable for four years. Production amounts to 8,000 tons, 10,900 tons, 7,500 tons, and 25,460 tons during the first four years respectively.

5. A colliery is worked under a lease granted by the lord of the manor at a royalty of 6d. per ton, with a minimum rental of £1,200. There is a right to recoup short workings, and the production amounts to 40,000 tons, 44,000 tons, 52,000 tons, and 50,000 tons respectively. Make out Ledger Accounts for Royalties, Landlord, and Overpaid Royalties. How would you treat Overpaid Royalties in the Annual Accounts.—(*National Union of Teachers.*)

CHAPTER XIX

JOINT VENTURES

A JOINT venture or adventure is a dealing or business association entered into by two or more persons or bodies, limited to a particular transaction, in which the parties agree to bear the expenses and to share the profit or loss in fixed proportions.

It is impossible to set down an exhaustive list of the transactions which may form the subject of a joint venture, but the more common include single building transactions, underwriting transactions, share speculations, consignments of goods and so on.

The Secretary and Joint Ventures.

It is quite possible for a company to enter into an agreement for a joint venture in association with another company, an individual, or a partnership; the secretary of a limited company is, therefore, just as likely to be called upon to keep records of joint ventures as is the accountant to a sole trader or a partnership.

Basis of Joint Venture Accounts.

The basis of Joint Venture Accounts is simple, provided that no attempt is made to deal with them by hard-and-fast rules. The secretary should think out carefully what would be the normal procedure of two joint venturers who have no knowledge whatever of accountancy principles or procedure. The parties agree to enter into a joint transaction for, say, the importation of a cargo of timber. One party is in a position to arrange for a favourable freight rate, and he agrees to bear the cost of the importing and the storing. The other is able to carry out the sale of the timber on

favourable terms, and agrees to attend to that aspect of the deal. At the close of the transaction the two parties meet and—without any recourse to accountancy—lay before each other a list of the expenses incurred or the proceeds realized. Each of the venturers then makes out, on a sheet of paper, a combined schedule or account of the total cost and the total proceeds. This memorandum shows a profit or a loss, which is divided into agreed proportions. If each party then adjusts his share of profit or loss to his own portion of the account, it can be seen at a glance which of the two must hand over a cheque to the other in settlement.

Accountancy Procedure.

The accountancy records of a joint venture should follow exactly the reasoned procedure set out above. If this is done, then the errors of principle which so frequently creep into Joint Venture Accounts will be avoided. Thus particular notice should be taken of the fact that to arrive at the profit or loss the joint venturers combine their respective outgoings and their respective receipts in a Memorandum Account. Many students fall into the error of endeavouring to bring this Memorandum Account into the double entry. This leads to incorrect accounts and to considerable confusion. Whilst there is no objection to keeping the Memorandum Account in the Ledger, its real nature must be kept continually in mind.

EXAMPLE. Cato and Junius enter into a joint venture for the importation and sale of a cargo of fruit. They agree to share profits and losses equally. Cato expends £12,400 on the purchase of the fruit, £1,960 on freight, £200 on insurance, and £22 on sundries, including storage. Junius pays the cost of advertising, £124; carriage and cartage, £205; incidental wages, £53; and collects by way of proceeds of sales, £17,890.

Entries in Cato's Books

Dr. **JOINT VENTURE WITH JUNIUS** *Cr.*

Date			£	s.	d.	Date			£	s.	d.
	To Purchases of Fruit	C.B.	12,400	–	–		By Cash received from Junius	C.B.	16,045	–	–
	,, Freight	C.B.	1,960	–	–						
	,, Insurance	C.B.	200	–	–						
	,, Sundries, Storage, etc.	C.B.	22	–	–						
	,, Profit on Venture	Jnl.	1,463	–	–						
		£	16,045	–	–			£	16,045	–	–

Dr. **PROFIT AND LOSS ACCOUNT** *Cr.*

Date			£	s.	d.	Date			£	s.	d.
							By Profit on Joint Venture with Junius	Jnl.	1,463	–	–

Entries in Junius's Books

JOINT VENTURE WITH CATO

Dr. *Cr.*

Date			£	s.	d.	Date			£	s.	d.
	To Advertising	C.B.	124	–	–		By Cash—				
	,, Carriage and Cartage	C.B.	205	–	–		Proceeds of Sales of Fruit	C.B.	17,890	–	–
	,, Incidental Wages	C.B.	53	–	–						
	,, Profit on Joint Venture	Jnl.	1,463	–	–						
	,, Cash paid to Cato	C.B.	16,045	–	–						
		£	17,890	–	–			£	17,890	–	–

PROFIT AND LOSS ACCOUNT

Dr. *Cr.*

Date			£	s.	d.	Date			£	s.	d.
							By Profit on Joint Venture with Cato	Jnl.	1,463	–	–

Cato and Junius

MEMORANDUM ACCOUNT

(Prepared by both parties, but not entered in the books of either except perhaps by way of Memorandum.)

	£	s.	d.		£	s.	d.
To Purchases of Fruit	12,400	–	–	By Sales of Fruit	17,890	–	–
,, Freight	1,960	–	–				
,, Insurance	200	–	–				
,, Sundries, Storage, etc.	22	–	–				
,, Advertising	124	–	–				
,, Carriage and Cartage	205	–	–				
,, Incidental Wages	53	–	–				
	14,964	–	–				
,, Profit divisible equally—							
Cato	1,463	–	–				
Junius	1,463	–	–				
£	17,890	–	–	£	17,890	–	–

Joint Venture Agreements.

The example given above is, of course, an extremely simple one, but it serves nevertheless to illustrate the principles upon which all joint ventures are recorded. Ventures which the secretary may be called upon to record will, in all probability, be subject to many conditions and provisions. It will be found, however, that in such cases the parties have entered into a written agreement, and this will simplify the secretary's work considerably.

The following is a list of some of the more usual conditions to be found in joint venture agreements—

	Remarks
1. A separate Banking Account to be kept.	Each party draws a cheque for his contribution, crediting "Cash" and debiting "Joint Venture."
2. Interest on Capital Advanced to be allowed.	The parties debit "Joint Venture" and credit their respective "Interest Accounts."
3. One of the parties is appointed manager to the Venture at a salary.	The managing party debits "Joint Venture" and credits either "Profit and Loss Account" or "Management Salary" with the remuneration.
4. The Venture to be managed entirely by a third party on a commission or a salary basis.	The venturers hand over their contributions to the third party, crediting "Cash" and debiting "Joint Venture." All accounts are then paid and received by the manager, who finally hands back to each venturer his contribution plus or minus his share of profit.

Practical Example.

The following practical example is now given in order to show that the same principles are followed in actual practice as in the simple theoretical illustration set out earlier in the chapter.

EXAMPLE. Jenkins and Boughton entered into a joint venture on 31st January. Profits were to be divided equally, but interest at 5 per cent was to be allowed to both parties. Jenkins bought goods on 1st February to the value of £1,240 and sent them on to Boughton for sale. He also paid insurance, £27 6s.; carriage, £75 1s.; at the same time he drew a bill on Boughton, payable 31st March, for £620 and discounted it with his bank on 4th February for £614 16s. 8d. Boughton paid dock dues and cartage, £32 16s. 8d., on 1st March, and insurance and customs duty, £57 15s. On 1st July, Boughton sold the goods for £1,911 5s. and paid, at the same time, £50 for storage and £124 for brokerage and incidentals. Settlement took place on 31st July, on which date Boughton sent a copy of his account to Jenkins, together with a cheque for £883 14s. 8d.

This example is illustrated on pages 248, 249, and 250.

SELF-EXAMINATION QUESTIONS. XIX

1. What is a joint venture? How is it recorded in the books of account?

2. Messrs. Lux and Lucifer, of Birmingham, consign on 1st February to M. Marconi, of Milano, 500 "Radiant" lamps at 18s. each, and pay freight (£5 18s. 6d.) and insurance (£2 15s.) One hundred and twenty-five lamps are damaged by storm, and M. Marconi receives £72 in settlement from the underwriters. He sells 250 lamps for £240, and on 4th April sends Account Sales and Banker's Draft in settlement to the consignors, after charging agency expenses (£5 10s.) and commission (£15 12s.). Set out the accounts in Lux and Lucifer's Ledger.—(*West Riding.*)

3. C and D buy on joint account 1,000 mining shares at 30s. plus expenses £10. C contributes one-third and D two-thirds of the price (all the moneys passing through a Joint Banking Account). Six hundred shares are sold at 32s. 6d. less expenses £7 5s., and 310 shares are sold at 31s. less £5 expenses. They divided the balance of the shares at cost price, and also any profit or loss, in proportion to their original contributions. Prepare Accounts showing the position at the close of the venture.—(*West Riding of Yorkshire.*)

Entries in Jenkins's Books

Dr. **"JOINT VENTURE WITH BOUGHTON"** *Cr.*

			Int.			Amount						Int.			Amount		
			£	s.	d.	£	s.	d.				£	s.	d.	£	s.	d.
Feb. 1	To Goods . .	B.J.	31	–	–	1,240	–	–	Feb. 4	By Net Proceeds of Bill Received from Boughton (£620 *less* Discount, £5 3s. 4d.)	C.B.	15	7	0	614	16	8
,, 1	,, Carriage & Freight	C.B.	1	18	–	75	1	–									
,, 1	,, Insurance . .	C.B.		14	–	27	6	–									
July 31	,, Net Interest chargeable .	Jnl.				18	5	–	July 31	By Cash received from Boughton in settlement .	C.B.				883	14	8
,, 31	,, Share of Profit transferred to P. & L. A/c .	Jnl.				137	19	4									
						£1,498	11	4							£1,498	11	4

Entries in Boughton's Books

Dr. **"JOINT VENTURE WITH JENKINS"** *Cr.*

			Int.			Amount						Int.			Amount		
			£	s.	d.	£	s.	d.				£	s.	d.	£	s.	d.
Feb. 1	To Bill Payable due 4th April.	B.B.	10	6	8	620	–	–	July 1	By Proceeds of Sale of Goods.	C.B.	7	19	4	1,911	5	–
Mar. 1	,, Dock Dues and Cartage	C.B.		13	4	32	16	8									
,, 1	,, Insce. & Customs.	C.B.	1	4	2	57	15	–									
July 1	,, Storage	C.B.		4	2	50	–	–									
,, 1	,, Brokerage and Incidentals	C.B.		10	4	124	–	–									
,, 31	,, Net Interest Chargeable	Jnl.				4	19	4									
,, 31	Share of Profit transferred to P. & L. A/c	Jnl.				137	19	4									
,, 31	,, Cash paid to Jenkins	C.B.				883	14	8									
						£1,911	5	–							£1,911	5	–

JENKINS AND BOUGHTON—JOINT VENTURE MEMORANDUM ACCOUNT

(Prepared by both parties, but not entered in the books of either except perhaps by way of Memorandum.)

		Mths.	Int. £	Int. s.	Int. d.	Amount £	Amount s.	Amount d.			Mths.	Int. £	Int. s.	Int. d.	Amount £	Amount s.	Amount d.
Feb. 1	To Goods	6	31	–	–	1,240	–	–	July 1	By Proceeds of Sale of Goods		7	19	4	1,911	5	–
,, 1	,, Carriage&Freight	6	1	18	–	75	1	–									
,, 1	,, Insurance	6		14	–	27	6	–	Feb. to Apr.	,, Net Interest on Proceeds of Bill		5	–	4			
Mar. 1	,, Dock Dues and Cartage	5		13	4	32	16	8									
,, 1	,, Insce. & Customs	5	1	4	2	57	15	–									
July 1	,, Storage	1		4	2	50	–	–									
,, 1	,, Brokerage and Incidentals	1		10	4	124	–	–									
Feb. 4	,, Discount on Bill for £620					5	3	4									
July 31	,, Interest—Net					23	4	4									
,, 31	,, Profit divisible equally—																
	Jenkins					137	19	4									
	Bowden					137	19	4									
						£1,911	5	–							£1,911	5	–

4. Black and White entered into partnership upon equal terms as to profits or losses of the venture, for the purpose of perfecting an invention with a view to its sale to a syndicate. No interest was to be paid upon partners' capital prior to division of results. Black contributed £300 and White £150 to cover the cost of experiments, White giving his personal services without salary.

Upon the completion of the necessary experiments, the purchases and expenses were found to have amounted to £478. Black then advanced a further £50, and White paid £22 for patent fees, etc.

The invention was sold by them to a syndicate for £1,000 in cash, which was paid to them, and 1,000 fully-paid shares of £1 each in the syndicate, and these were duly allotted.

Upon dissolving the partnership, White arranged to take over the stock of materials at an agreed valuation of £36, and undertook to discharge outstanding liabilities (if any). Black consented to take over the 1,000 fully-paid shares at an agreed valuation of £50.

Prepare the accounts necessary upon the dissolution of partnership.—(*Royal Society of Arts.*)

CHAPTER XX

CONSIGNMENTS INWARDS AND OUTWARDS

CONSIGNMENTS of goods are made by a consignor to a consignee for the purpose of sale by the latter. The goods are actually sent to the consignee and not merely sold by him from sample. The distinction between a purchase of goods and a receipt of a consignment by a consignee must be borne in mind constantly. In the former case the property in the goods passes from the seller to the buyer, but in the latter case it is the possession only which is transferred. If this one important fact is kept in view, then no errors of principle are likely to occur in the recording of consignments.

Consignments Inwards.

Contrary to usual practice, the secretarial student is advised to devote his attention to inward consignments before turning to the study of consignments outward. This procedure disposes of the confusion which often arises in the student's mind when he deals with the entries relating to outward consignments before he has studied the simpler but corresponding entries in the books of the consignee.

There are no rules relating to consignments inward and, in practice, the secretary is free to devise his own method of recording them according to the particular circumstances of each case. When his company receives a parcel of goods on consignment, a note of the quantities, values, and other details should be entered in a Memorandum Book or file. The details may even be kept in the Ledger, provided the account is clearly marked "Memorandum." Under no circumstances must the receipt of the goods be entered in the

Purchase Journal or the value be credited to a personal account of the consignor.

Sales of Consignment Goods.

On the sale of goods by a consignee, his relationship *vis-à-vis* the consignor immediately changes. He becomes a debtor and must therefore credit the consignor with the net amount due to him. This is done by opening a personal account in the name of the consignor, and crediting it either with the gross proceeds of the sales and debiting it with the agreed commission, or by crediting it with the net amount due. The former is the preferable course. Should the consignee be called upon to pay any charges on behalf of the consignor, e.g. duty, freight, storage, etc., he credits his Cash Book and debits the consignor's personal account. The consignee then sends a cheque to the consignor in settlement, crediting cash and debiting the consignor's personal account in the usual way. This closes the whole transaction, which, it will be agreed, involves no accounting difficulty or problem of any kind.

EXAMPLE. The Ganges Co., Ltd., offers to sell a parcel of goods on consignment for the A.B.C. Manufacturing Co., Ltd., for a commission of 5 per cent. The goods have a selling value of £1,284, and they are duly sold net to the Zodiac Trading Co., Ltd., on 1st July, 1936. The consignees received the goods on 15th June, received the cash on 30th July, and settled with the consignors on 8th August. It is required to tabulate the procedure followed by the secretary of the Ganges Co., Ltd.

1. On receipt of the goods from the A.B.C. Manufacturing Co., Ltd., the secretary of the Ganges Co., Ltd., calls for the *pro forma* invoice or similar document sent by the consignors. This document, which gives quantities, weights, selling prices, etc., is entered

in a Memorandum Account under date 15th June, 1936.

2. On 1st July, 1936, the Zodiac Trading Co., Ltd., is debited with £1,284 in respect of the goods sold to them net, the corresponding credit being made to an account called "The A.B.C. Manufacturing Co., Ltd."

3. Simultaneously, the Ganges Co., Ltd., debits the A.B.C. Manufacturing Co., Ltd., with 5 per cent commission on £1,284, i.e. £64 4s., the corresponding credit being made to "Commission Account" or some similar account, e.g. "Profit on Consignments Inwards Account."

4. On 30th July the Ganges Co., Ltd., credits the Zodiac Trading Co., Ltd., with £1,284 received from the latter company in respect of the goods sold, the corresponding debit being made in the Cash Book.

5. On 8th August the secretary of the Ganges Co. Ltd. sends a cheque for £1,219 16s. to the A.B.C. Manufacturing Co., Ltd., debiting the account of that company and crediting "Cash."

Special Arrangements.

From time to time special arrangements are made between consignor and consignee which may lead to slight variations in the procedure outlined above.

It may be stipulated by the consignor, for example, that a deposit shall be made by the consignee as security for the goods placed in his possession. In such a case a personal account in the name of the consignor must be opened at once by the consignee without waiting for the sale of the goods. The Cash Book will be credited and the consignor's account will be debited with the agreed deposit.

In other cases the consignor arranges to draw a bill on the consignee, such bill likewise to be regarded as a deposit or an advance. The same procedure is followed under these circumstances except that the credit

is made by the consignee in his Bills Payable Account instead of in his Cash Book.

"Del Credere."

It must be remembered that the consignee sells—as a general rule—to his own customers, and that the latter are usually unknown to the consignor. This circumstance gives rise to a very common custom whereby the consignee guarantees the solvency of the debtors who purchase the consignor's goods through him. In return for assuming all responsibility for bad debts, the consignee receives an additional commission which is known as *del credere* commission.

Consignments Outward.

Having grasped the simple procedure followed by a consignee, the student should now have no difficulty in understanding the accounting entries made by a consignor. If he is in doubt as to the stage at which the consignor is to treat his consignee as a debtor, he need only recall the corresponding stages in the records kept by the consignee in his books. This will obviate any possibility of treating consignments as sales at too early a step or of regarding the consignee as a debtor before he has disposed of the goods.

Goods on Consignment Account.

The consignor is unable to record the dispatch of goods to consignees in a Memorandum Account; to do so would be equivalent to excluding a part of his assets from the books. On the other hand, he cannot credit Sales Account, as the goods have not been sold. He therefore opens an account which, for all practical purposes, may be regarded as a Suspense Account. This account is generally known as "Goods on Consignment Account," and is credited with the cost price of the goods sent to consignees. If the periodical entries

are numerous, it is usual to open a Consignments Journal—ruled to suit the particular business—and to post the total of this Journal at monthly or other intervals to the credit of "Goods on Consignment" Account in the Ledger.

The corresponding debits—which are posted from the Consignment Journal where such book is kept—are entered in the Ledger, a separate account being devoted to the consignment sent to each separate consignee. The title of each of these accounts is so arranged as to identify it with the consignee, e.g. "Consignment to the Ganges Co., Ltd.," or "Consignment No. 414—sent to the Ariel Co., Ltd.," etc. In spite of these references to the consignees in the titles of the accounts, the secretary must remember always that they are *impersonal* accounts and not personal accounts with the Ganges Co., Ltd., the Ariel Co., Ltd., and so on.

Advances by Consignees.

As mentioned earlier in the chapter, it is quite usual for consignors to demand advances by consignees against the goods forwarded. When such advances are received they must be debited in the consignor's Cash Book and credited to personal accounts opened in the name of each consignee. Under no circumstances must they be credited to the Consignment Accounts or to any impersonal account.

Charges on Consignments.

The disbursements outward, such as insurance, freight, cartage, etc., are, of course, borne by the consignor, unless there are very unusual arrangements to the contrary. These charges are debited by the consignor to the appropriate consignment accounts, any general charges being allocated on some equitable or convenient basis.

Account Sales.

The notification of sales made by a consignee is usually communicated to the consignor by means of an Account Sales. This is a document which sets out particulars of the amount realized for the consignment, and shows the deductions which have been made by the consignee in respect of his commission and any out-of-pocket expenses and charges he may have incurred. The Account Sales (A/S) is accompanied, as a rule, by a cheque or bill for the net balance due to the consignor.

Entries in the Consignment Account.

On receipt of the remittance and the Account Sales, the consignor credits the personal account of the consignee with the former and enters details of the latter in the relative Consignment Account. It is customary to enter the gross proceeds as a credit, and the consignee's commission and charges as debits, although some secretaries enter only the net proceeds as a credit. In either case, the corresponding entries are made in the personal account of the consignee, between whom and the consignor the relationship of debtor and creditor arises on the sale of the goods.

Closing the Consignment Account.

The account relating to each consignment is closed off on the sale of the whole consignment, although it is usual to balance the accounts and carry down appropriate balances should the end of the consignor's trading year intervene. The " Goods on Consignment Account " is closed off at the end of the trading year by transferring it to the credit of the consignor's trading account.

The process of closing each Consignment Account presents no difficulty. If the whole of the goods have been disposed of and the Account Sales duly entered,

then the balance on the account will represent the net profit or the net loss on the consignment, and will be transferred to the credit or debit of Profit and Loss Account. If a proportion of the goods remain unsold, then a balance representing "Stock of Goods on Consignment" must be carried down as a debit balance. The value at which such stock is to be carried down is arrived at by adding to the cost price of the unsold goods a proportionate part of the charges incurred by the consignor and by the consignee.

EXAMPLE. For purposes of illustration, we will adopt, with the necessary elaboration, the example used to illustrate the consignee's accounts (see pages 253 and 254). The A.B.C. Manufacturing Co., Ltd., consigns on 1st June to the Ganges Co., Ltd., a parcel of goods costing £900. The freight and charges amounted to £126, the insurance to £44, and the cartage to £28. On 29th June the A.B.C. Manufacturing Co., Ltd., receives a cheque for £500 from the Ganges Co., Ltd., by way of advance. On 30th June the A.B.C. Manufacturing Co., Ltd., decides to make up its annual accounts and receives, on the same day, a notification to the effect that half the goods have been sold for £642 gross. On 8th August the A.B.C. Manufacturing Co., Ltd., receives an Account Sales for the consignment, together with a cheque for £719 16s., the balance of the goods having been sold as set out in the earlier example given on page 254.

The actual accounts as they would appear in the consignor's Ledger, are set out on pages 259 and 260.

Names of Accounts.

The names given to the various accounts used in this chapter are those which must be used by the student for examination work. The secretary of a company may vary them as he pleases, and it is quite usual nowadays to find different companies using

ENTRIES IN THE BOOKS OF THE A.B.C. MANUFACTURING CO., LTD.

THE GANGES CO., LTD.

Dr. *Cr.*

1936			£	s.	d.	1936			£	s.	d.
June 30	To Sales of Goods on Consignment	Jnl.	609	18	–	June 29	By Cheque	C.B.	500	–	–
Aug. 8	,, Sales of Balance of Goods per Account Sales	Jnl.	609	18	–	Aug. 8	,, ,,	C.B.	719	16	–
			£1,219	16	–				£1,219	16	–

CONSIGNMENT TO THE GANGES CO., LTD.

Dr. *Cr.*

1936			£	s.	d.	1936			£	s.	d.
June 1	To Goods sent on Consignment	Jnl.	900	–	–	June 30	By Sales of Half the Consgmt. £642 – – *Less* Commn. 32 2 –	Jnl.	609	18	–
,, 1	,, Freight and Charges	C.B.	126	–	–						
,, 1	,, Insurance	C.B.	44	–	–						
,, 1	,, Cartage	C.B.	28	–	–	,, 30	,, Stock of Goods on Consignment at cost	c/d	549	–	–
,, 30	,, Transfer of Profit to Profit and Loss A/c	Jnl.	60	18	–						
			£1,158	18	–				£1,158	18	–
1936			£	s.	d.	1936			£	s.	d.
July 1	To Stock of Goods on Consignment	b/d	549	–	–	Aug. 8	By Sales per Account Sales rendered by Ganges Co., Ltd.— £ s. d. Gross £642 – – *Less* Commn. 32 2 –	Jnl.	609	18	–
Aug. 8	,, Transfer of Profit to Profit and Loss A/c	Jnl.	60	18	–						
			£609	18	–				£609	18	–

Dr. **GOODS ON CONSIGNMENT ACCOUNT** *Cr.*

1936			£	s.	d.	1936			£	s.	d.
June 30	To Transfer to Trading A/c .	Jnl.	900	–	–	June 1	By Consignment to the Ganges Co., Ltd. . . .	Jnl.	900	–	–

THE A.B.C. MANUFACTURING CO., LTD.

EXTRACTS FROM TRADING AND PROFIT AND LOSS ACCOUNT AT 30TH JUNE, 1936

Dr. **TRADING ACCOUNT** *Cr.*

						1936			£	s.	d.
						June 30	By Sales		–	–	–
						,, 30	,, Goods sent on Consignment		900	–	–

Dr. **PROFIT AND LOSS ACCOUNT** *Cr.*

						1936			£	s.	d.
	(*Note.* The balance of the profit on the Consignment will be credited to this account in the following financial year)					June 30	By Profit on Consignment to the Ganges Co., Ltd., to date		60	18	–

entirely different titles for accounts which are identical in their nature. The reason for this is that secretaries find a tendency among their book-keepers to become confused between the Consignment Account and the personal account, and between the Consignment Account and the Goods on Consignment Account. This confusion is understandable and perhaps inevitable if the textbook procedure is adhered to. In practice, the secretary overcomes the difficulty by opening two personal accounts in the name of the consignee, one of which is distinguished by the words (Consignment Account) inserted in brackets after the name. This account corresponds to the impersonal Consignment Account with which we have been dealing. It is true that this procedure is tantamount to a violation of theoretical principles and, for that reason, it must be avoided by the student. At the same time it emphasizes the distinction between the true personal account of the consignee and his Consignment Account.

Another deviation from strict theory is to be found in the common practice of calling the Goods on Consignment Account the "Sales of Goods on Consignment" Account. This variation again must not be used for examination purposes, although it has much to recommend it for practical purposes. Secretaries who employ it give as their reason that, whilst it is true that goods sent on consignment are not sold as soon as they are dispatched, yet the use of such a title prevents the book-keeper from crediting such an account with the proceeds shown in the consignee's Account Sales. He cannot fail to credit the sales of the goods to the Consignment Account.

Trading Account Entries.

It is sometimes claimed that it is an error of principle to transfer the "Goods on Consignment" Account to Trading Account at the end of a period, unless the

goods have been fully disposed of. This question affects also the procedure governing "Branch Accounts," which is dealt with in a later chapter.

Whilst the matter is not of great moment to the student, it may prove of interest to the secretary, and for that reason the alternative practice will be found set out fully in an Appendix.

SELF-EXAMINATION QUESTIONS. XX

1. What is the distinction between a sale of goods and a dispatch of goods on consignment?

2. Tabulate the procedure followed by a consignor in recording the dispatch of goods to a consignee and the disposal of the goods by the latter.

3. Richard Random & Sons shipped goods to Paul Gold, their agent at Cape Town on 1st September, and sent therewith a *pro forma* invoice for £578 (goods £500, freight £60, and insurance £18). On 28th October, Paul Gold sent home an Account Sales, from which it appeared that a portion of the goods had realized £460; and, deducting expenses £10 and commission £25, he enclosed a draft at three months for the balance. The stock remaining unsold amounted, at invoice prices plus expenses, to £280. On 2nd November, he sent home another Account Sales, which showed that the balance of the consignment had realized £320, which, less £8 expenses and £10 commission, he remitted by a three months' draft. Show how the above transactions should appear in the books of Richard Random & Sons.—(*Royal Society of Arts.*)

4. What is an "Account Sales?" On 15th October, Delmaine Bros., London, shipped to Donnison & Sons, Port Elizabeth, 60 cases of mixed Sheffield goods. These goods were invoiced *pro forma* at £32 10s. per case. The London payments in connection with this consignment were: Insurance, £10 12s.; freight, £54 12s.; sundry charges, £3 15s. The payments made by Donnison & Sons, in South Africa, were: Storage, £16 12s.; landing charges, £6 10s.; insurance, £2 11s. On 15th December, Donnison & Sons sold 30 cases of goods at £45 per case; on 17th December, 25 cases at £50 per case; and on 19th December, the balance of the consignment at £51 per case. All the above sales were effected for prompt cash. A commission is payable to Donnison & Sons of 2 per cent on all sales plus 1½ per cent *del credere* commission. On 1st November, Delmaine Bros. drew a bill on Donnison & Sons for £1,000. This draft was duly accepted. Show how the transactions would appear in the books of Delmaine Bros.—(*London Chamber of Commerce.*)

CHAPTER XXI

BRANCH ACCOUNTS

"BRANCH ACCOUNTING" is not a system of accountancy or a method of keeping books differing from that we have studied throughout the preceding pages. It is the name given to the very slight elaborations which have to be adopted when a company trades through branch establishments as well as at a central house. And these elaborations vary with each business, for the records are designed in every case to suit the given conditions, and are framed to provide the particular information demanded by individual boards of directors.

As a direct consequence of the above, the secretary may take it that there is no one set method of branch accounting. He may quite possibly find, in practice, that the peculiar circumstances of his company's trading demand elaborations of branch accounts which are entirely dissimilar to any method laid down in text-books. This being so, he should bear in mind that this present chapter deals with principles only, and that the illustrations or applications of principles to details should not be permitted to obscure the all-important fact that branch accounts must be fitted to the business. Under no circumstances must the branch managers be forced to keep elaborate records for the sake of conforming to what is termed, erroneously, a system of branch accounts.

Books at Head Office.

The first general principle to be laid down is that the books of account should be kept at the head office wherever possible. This means that branch accounting, in its true sense, should not be resorted to unless and

until it is finally forced upon the company by circumstances.

The effect of this principle serves to counter the very general but harmful argument that the mere opening of a branch should be followed immediately by the introduction of separate branch records.

Single Branches.

We will first examine the case of a company owning a single branch. Such a company may arrange to take the lease of a shop or showroom in another town and to appoint a manager, whose sole duty it shall be to receive the company's customers, exhibit the wares which the company manufactures, and pass on any orders he may receive to the central or head office. Now in such a case the secretary should avoid the installation of any books of account at the branch. The appropriate "system" would be framed on lines more or less in accord with the following—

1. The branch manager would be provided with a duplicate Order Book.

2. The orders forwarded to head office would be treated in exactly the same manner as would any orders taken direct.

3. The rent, rates, and other main expenses of the branch office would be paid by cheque by the head office.

4. If the branch manager were to be remunerated by a commission on the sales he effects, then some means of identifying his customers' accounts in the Head Office Accounts would be adopted.

5. Should the directors desire to be informed as to the separate profit earned by the branch, then the analysis of the income and outgoings would be effected either by the adoption of appropriate columns in the subsidiary books or by "starring" all items applicable to the branch.

Multiple Branches.

Whether the procedure to be adopted by a company owning a large number of branches differs from that outlined above, depends entirely upon the nature of the trade. If, for example, the duty of each branch consisted of nothing more than the booking of orders for goods to be manufactured, then the method followed would be no different from that applicable to the single "branch-showroom" explained in the preceding paragraph. If, however, the company's trade is such that the branches function as retailing depots, then the accounting is slightly different.

Firstly, the secretary must determine whether any books are to be kept at the branches or whether all the book-keeping shall be carried out at the head office. It is impossible to decide this question until the facts of the particular company's trade is known. Generally speaking, however, it will be found that if the branches sell goods for cash only, then they need keep no books forming part of the company's double entry system. Their records will usually be confined to statistical memoranda, and stock books, and a bank paying-in book for recording their remittances of cash to the head office banking account.

If, on the other hand, the company's branches are more than mere retailing depots, it may be necessary to open a considerable number of books. The extent to which this installation is carried depends entirely on circumstances, and the secretary must exercise a considerable amount of judgment. Occasionally one encounters an organization in which it is the policy to treat all branches as self-contained units, practically independent of the head office and subject only to the control of the board of directors. In these cases it may be found that the books kept at the branches constitute a complete set. The only link with the head office, under such conditions, is to be found in the

current accounts kept in the head office books for each branch.

Credit Sales at Branches.

Reverting to the simpler case of the "retailing-depot" branch, it may be found that the branch manager is permitted to sell goods, within certain defined limits, on credit as well as for cash. If so, then it will be necessary to keep one or more Sales Ledgers, in addition to the statistical records to which reference has been made.

Branch Expenses.

Wherever possible, the payment of all outgoings for salaries, rent, rates, and other overhead expenses should be made from the head office. This permits the secretary to maintain a constant check upon the whole of the company's expenditure. In addition, it affords a more adequate safeguard against misappropriation of funds.

There are instances—such as those in which each depot has to be treated as an independent unit—where payments to creditors for expenses cannot be made from the head office. Here again the system must be adapted to the business, and steps must be taken to provide the branch with purchase or expense journals and personal ledgers for the creditors' accounts.

Goods Sent to Branches.

All consignments of goods from head office are credited to "Goods sent to Branches" Account and not to "Sales." The reason for this procedure will be seen from the following example: A head office forwards a stock of goods, to the value, at cost prices, of £1,000 on 1st January. The goods are sold for £1,250 cash during the month of January, and the proceeds are duly remitted to head office before 31st January.

The mere dispatch of goods to the branch does not constitute a sale but, at the same time, a proper record of the consignment must be kept. To do this the secretary could adopt one of two courses—

1. (*a*) He could keep a note of the dispatch of the goods in a memorandum account only, making no entry in the financial books.

(*b*) On receipt of notification of the sale of the goods for £1,250, and also on receipt of the cash, he could debit his Cash Book and credit Sales with this amount.

Or, alternatively—

2. (*a*) He could credit the goods sent to the branch (£1,000) to a type of suspense account, called "Goods sent to Branch." The corresponding debit would be made to a personal account opened in the name of the branch.

(*b*) On the sale of the goods for £1,250, the branch would be debited with the profit of £250, the corresponding credit being made to the "Goods sent to Branch."

(*c*) The total debit of £1,250 against the branch would be offset by crediting the cash received.

(*d*) The total credit of £1,250 on "Goods sent to Branch" Account, having assumed the character of "Sales," could now be transferred to the credit of Sales Account.

It is emphasized that the procedure tabulated above is theoretical only, for in practice it is extremely unlikely that the exact amount of goods sent to branches will be disposed of within each set financial period. In addition, the theoretical steps which we have listed do not, of themselves, show the net profit arising on the branch's trading.

None the less, the theory has been set out with a view to emphasizing the nature of the "Goods sent to Branches" Account, with which we now have to deal. It is found that more confusion arises in the student's

mind in connection with this point than on any other.

Transfers at Selling Prices.

The usual practice with companies owning a number of retailing depots is to charge out all goods sent to branches at selling prices. The principal object of this step is that it maintains a closer control over the stock and, consequently, over the branches. Each branch is required to account, either in cash or in stock, for the total goods sent to it. This prevents losses of stock by pilferage or from other causes being obscured by the profit realized at the branch.

The point to be observed in connection with this method is that great care must be taken to prevent credit being taken in the periodical accounts for any profit which has not been earned. This could arise if the closing stock on hand at the branch or branches were taken into the accounts at selling price. At the end of the appropriate financial periods it is therefore necessary for the secretary to eliminate the "loading" which has been added to cost when charging the goods out to the branches.

Double Column Records.

In order to keep a constant record of the cost and the selling price of all goods dealt with by branches, the secretary should arrange to have the accounts relating to each branch, and the corresponding journals, ruled with double columns. This method, which is adopted in the illustrations below, enables the book-keeper to record cost and selling price simultaneously. In this way it affords great assistance in the adjustment of the branch stock values at balancing time.

Branch Profit and Loss Accounts.

It is now the established practice, wherever possible, to keep the Ledger Accounts in such a form that the

profit or loss at each branch can be seen at a glance. This is brought about by treating the account of each branch not only as a personal account, but also as the Profit and Loss Account for the branch. It is this custom which renders the theoretical procedure discussed earlier in the chapter unsuited to practical requirements.

The student may find it difficult to visualize the same Ledger Account as a personal and as an impersonal account simultaneously. If he follows the subjoined example carefully, however, he should experience no trouble.

EXAMPLE. The Multiple Tea Co., Ltd., has 400 branches, of which one is situated at Luton. The London Office always adds 25 per cent to its costs to arrive at retail selling price, and the goods sent to Luton were as follows—

EXTRACT FROM "BRANCH SUPPLIES JOURNAL"

1936		Cost			Selling Price		
		£	s.	d.	£	s.	d.
Jan. 1–31	Luton Goods . .	21,177	3	9	26,471	9	8
Feb. 1–29	Luton Goods . .	23,150	10	8	28,938	3	4
Mar. 1–31	Luton Goods . .	25,770	8	8	32,213	–	10
		£70,098	3	1	£87,622	13	10

The expenses for the three months were as under—

	January			February			March		
	£	s.	d.	£	s.	d.	£	s.	d.
Salaries	137	9	10	138	2	–	140	3	–
Rent	152	6	–	152	–	–	155	10	–
Rates	50	3	–	55	3	–	48	2	6
General Expenses . .	212	9	8	215	7	4	216	7	2

The sales were as follows—

	£	s.	d.
January . . .	25,400	10	6
February . . .	27,740	8	8
March. . . .	33,340	10	10
	£86,481	10	–

There is no opening stock, but the branch accounts are made up monthly. The appropriate entries in the "Goods sent to Branches Account" and in the "Luton Branch Account" are illustrated fully on pages 271 to 274. They should be studied closely in conjunction with the following paragraph which serves to explain them.

Ascertainment of Gross Profit.

The gross profit shown in the Luton Branch Account is arrived at by adjusting the "loading" contained in the stock-in-trade. As the goods have been charged out at selling price, the difference on the trading account section under the "Selling Price" column must represent stock-in-trade at selling price. All that is necessary, therefore, is to deduct the profit contained in this figure and enter the balance in the "Adjusted Prices" column. In the example we have just considered we were told that 25 per cent was always added to cost to arrive at the retail price. The monthly stock is, therefore, subjected to a deduction of 20 per cent in order to rectify the matter before determining the real profit for each period. The effect of the adjustment may be illustrated as follows—

	Stock at Selling Prices	Less 20%	Correct Value of Stock for Trading A/c Purposes
1936	£ s. d.	£ s. d.	£ s. d.
Jan. 31 . .	1,070 19 2	214 3 10	856 15 4
Feb. 29 . .	2,268 3 10	453 12 9	1,814 11 1
Mar. 31 . .	1,240 13 10	248 2 9	992 11 1

THE MULTIPLE TEA CO., LTD.

Dr. GOODS SENT TO BRANCHES ACCOUNT *Cr.*

				£	s.	d.
	1936 Jan. 1–31	By Sundries per Branch Supplies Journal (including Luton Branch, amtng. to)	B.S.J.	21,177	3	9
Note. This account would not be closed off until the end of the year. It would then be transferred to the credit of Trading Account	Feb. 1–29	,, Sundries per Branch Supplies Journal (including Luton Branch, amtng. to)	B.S.J.	23,150	10	8
	Mar. 1–31	,, Sundries per Branch Supplies Journal (including Luton Branch, amtng. to)	B.S.J.	25,770	8	8

THE MULTIPLE TEA CO., LTD.

LUTON BRANCH ACCOUNT FOR JANUARY

Dr. *Cr.*

			Selling Prices			Adjusted Prices							Selling Prices			Adjusted Prices		
1936			£	s.	d.	£	s.	d.	1936			£	s.	d.	£	s.	d.
Jan. 1–31	To Goods supplied from Head Office	B.S.J.	26,471	9	8	21,177	3	9	Jan. 1–31	By Cash in respect of Sales	C.B.	25,400	10	6	25,400	10	6
„ 31	„ Gross Profit	c/d				5,080	2	1	„ 31	„ Stock-in-Trade	c/d	1,070	19	2	856	15	4
		£	26,471	9	8	26,257	5	10			£	26,471	9	8	26,257	5	10
„ 1–31	To Salaries	C.B.				137	9	10	„ 31	By Gross Profit.	b/d				5,080	2	1
„ 1–31	„ Rent	C.B.				152	6	–									
„ 1–31	„ Rates	C.B.				50	3	–									
„ 1–31	„ General Exps.	C.B.				212	9	8									
„ 31	„ Net Profit transferred to Profit and Loss A/c	Jnl.				4,527	13	7									
						£5,080	2	1							£5,080	2	1

THE MULTIPLE TEA CO., LTD.

Dr. LUTON BRANCH ACCOUNT FOR FEBRUARY *Cr.*

			Selling Prices			Adjusted Prices						Selling Prices			Adjusted Prices		
1936			£	s.	d.	£	s.	d.	1936			£	s.	d.	£	s.	d.
Feb. 1	To Stock-in-Trade	b/d	1,070	9	2	856	15	4	Feb. 1–29	By Cash in respect of Sales	C.B.	27,740	8	8	27,740	8	8
,, 1–29	,, Goods supplied from Head Office.	B.S.J.	28,938	3	4	23,150	10	8	,, 29	,, Stock-in-Trade	c/d	2,268	3	10	1,814	11	1
,, 29	,, Gross Profit	c/d				5,547	13	9									
		£	30,008	12	6	29,554	19	9			£	30,008	12	6	29,554	19	9
,, 1–29	To Salaries	C.B.				138	2	–	,, 29	By Gross Profit	b/d				5,547	13	9
,, 1–29	,, Rent	C.B.				152	–	–									
,, 1–29	,, Rates	C.B.				55	3	–									
,, 1–29	,, General Exps.	C.B.				215	7	4									
,, 29	,, Net Profit transferred to Profit and Loss A/c	Jnl.				4,987	1	5									
						£5,547	13	9							£5,547	13	9

THE MULTIPLE TEA CO., LTD.

LUTON BRANCH ACCOUNT FOR MARCH

Dr. *Cr.*

			Selling Prices			Adjusted Prices							Selling Prices			Adjusted Prices		
1936			£	s.	d.	£	s.	d.	1936				£	s.	d.	£	s.	d.
Mar. 1	To Stock-in-Trade	b/d	2,268	3	10	1,814	11	1	Mar. 1–31	By Cash in respect of Sales	C.B.		33,340	10	10	33,340	10	10
,, 1–31	,, Goods supplied from Head Office	B.S.J.	32,313	–	10	25,770	8	8	,, 31	,, Stock-in-Trade	c/d		1,240	13	10	992	11	1
,, 31	,, Gross Profit	c/d				6,748	2	2										
		£	34,581	4	8	34,333	1	11				£	34,581	4	8	34,333	1	11
,, 1–31	To Salaries	C.B.				140	3	–	,, 31	By Gross Profit	b/d					6,748	2	2
,, 1–31	,, Rent	C.B.				155	10	–										
,, 1–31	,, Rates	C.B.				48	2	6										
,, 1–31	,, General Exps.					216	7	2										
,, 31	,, Net Profit transferred Profit and Loss A/c					6,187	19	6										
						£6,748	2	2								£6,748	2	2

Stock Shortages.

Whilst the interim monthly accounts of a multiple shop company may be based upon a "paper" stock-taking, such as that incorporated in the illustration, it is usual to have the stock taken physically at frequent intervals. Sometimes it is stipulated that the branch manager shall take stock at the end of every month and then notify the head office of any discrepancies which may come to light.

In other cases the organization includes a number of travelling inspectors, whose duty it is to make a physical check of the stock at the branches they visit. Needless to say, there is always at least a small difference due to wastage, evaporation, errors in weighing, and similar causes; as long as the discrepancy is not serious, the branch manager is permitted to show it in his periodical return as "Shortage in Stock."

Treatment of Shortages in the Branch Account.

The treatment of the normal shortage in the Branch Account kept at the head office is simple. It is entered only in the "Selling Prices" column in order to balance the account. It is not entered as an adjusted figure, but the actual value of the stock is credited instead of the paper value. In order to illustrate the point, we will assume that the Luton Branch, in the example we have already considered, found that the stock at 31st March amounted to £1,232 6s. 3d. instead of £1,240 13s. 10d. This represents a shortage of £8 7s. 7d. at selling prices, and the adjusted value of the stock-in-trade is, therefore, £985 17s. instead of £992 11s. 1d.

The adjustment of the shortage is carried out as shown on page 276.

Branch Debtors.

The treatment of branch debtors depends, to a large extent, upon whether the credit sales are few in number

LUTON BRANCH ACCOUNT

(Illustrating the treatment of a normal stock shortage)

Dr. *Cr.*

			Selling Prices			Adjusted Prices							Selling Prices			Adjusted Prices		
			£	s.	d.	£	s.	d.					£	s.	d.	£	s.	d.
1936 Mar. 1	To Stock-in-Trade		2,268	3	10	1,814	11	1	1936 Mar. 1–31	By Cash in respect of Sales	C.B.		33,340	10	10	33,340	10	10
„ 1–31	„ Goods supplied from Head Office	B.S.J.	32,313	–	10	25,770	8	8	„ 31	„ Actual Stock in Trade	c/d		1,232	6	3	985	17	–
„ 31	„ Gross Profit	c/d				6,741	8	1	„ 1–31	„ Stock Shortage written off	—		8	7	7	—	–	–
		£	34,581	4	8	34,326	7	10				£	34,581	4	8	34,326	7	10
Mar. 1–31	To Salaries	C.B.				140	3	–	Mar. 31	By Gross Profit	b/d					6,741	8	1
„ 1–31	„ Rent	C.B.				155	10	–										
„ 1–31	„ Rates	C.B.				48	2	6										
„ 1–31	„ General Exps.	C.B.				216	7	2										
„ 31	„ Net Profit transferred to Profit and Loss A/c	Jnl.				6,181	5	5										
						£6,741	8	1								£6,741	8	1

and of small amount, or whether they represent a considerable proportion of the branch turnover. If they are practically negligible, then it is usual to treat them in the same way as the stock is treated; that is to say, they are carried down in the Branch Account as though they represented opening and closing stocks of debtors.

If the credit sales are considerable, then the secretary will probably find it necessary to open a "Branch Debtors' Account" for each branch. This account is very similar to the Adjustment or Total Account which is kept in self-balancing Ledgers. The information from which it is compiled is taken from the returns sent in by the branch manager, and it follows, therefore, that the Sales Ledgers maintained at the branches must be kept on the self-balancing principle.

Illustrations are given below of the two methods outlined above. Both are based on the accounts of the Bedford Branch of the Retail Tea Co., Ltd.; but in the first case it is assumed that the credit sales are very small, whilst in the second case they form the bulk of the turnover.

EXAMPLE "A." The Bedford Branch returns for June, 1936, shows the following—

	£	s.	d.
Goods received from Head Office at Selling Prices (33⅓% on Cost)	5,280	6	9
Goods returned to Head Office	49	3	3
Cash remitted to Head Office	5,157	9	9
Debtors at 1st June	38	10	10
Debtors at 30th June.	42	9	8
Branch Expenses	22	9	–

The following items were paid by the Head Office—

	£	s.	d.
Rent and Rates	122	6	6
General Expenses	14	2	3
Stock on hand, 1st June	240	9	9
Stock on hand, 30th June	310	4	8

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BEDFORD BRANCH ACCOUNT (Example "A")

Dr. *Cr.*

			Selling Prices			Adjusted Prices						Selling Prices			Adjusted Prices		
1936			£	s.	d.	£	s.	d.	1936			£	s.	d.	£	s.	d.
June 1	To Stock-in-Trade.	b/d	240	9	9	180	7	4	June 30	By Goods returned .	B.R.	49	3	3	36	17	5
„ 1	„ Debtors at beginning of month . .	b/d	38	10	10	38	10	10	„ 30	„ Cash remitted from Branch .	C.B.	5,157	9	9	5,157	9	9
			279	–	7	218	18	2	„ 30	„ Stock-in-Trade .	c/d	310	4	8	232	13	6
1–30	„ Goods supplied from Head Office . .	B.S.J.	5,280	6	9	3,960	5	1	„ 30	„ Debtors at end of month .	c/d	42	9	8	42	9	8
„ 30	„ Gross Profit .	c/d				1,290	7	1									
			£5,559	7	4	£5,469	10	4				£5,559	7	4	£5,469	10	4
June 1–30	To Expenses paid by Branch .	B.R.				22	9	–	June 30	By Gross Profit .	b/d				1,290	7	1
„ 1–30	„ Rent and Rates	C.B.				122	6	6									
„ 1–30	„ General Exps. .	C.B.				14	2	3									
„ 30	„ Net Profit for the Month .	Jnl.				1,131	9	4									
						£1,290	7	1							£1,290	7	1

EXAMPLE "B." In Example "B," the debtors' accounts are kept at the branch, and the following are the figures appearing in the Branch Return for June, 1936. It is required to enter these items in the appropriate head office accounts, raising a separate "Bedford Branch Debtors' Account" for the credit sales. These credit sales are to be debited in the "Bedford Branch Debtors' Account" and credited in the "Bedford Branch Account."

	£	s.	d.
Stock at 1st June, 1936	284	4	4
Goods sent from Head Office (at cost plus 33⅓%)	4,824	8	8
Debtors at 1st June, 1936	2,320	8	8
Debtors at 30th June, 1936	1,558	15	9
Discounts allowed	88	3	5
Bad Debts written off	28	6	–
Cash Sales	2,300	10	8
Cash received from Debtors	3,140	15	10
Stock at 30th June, 1936	312	10	–

The undermentioned items appear in the Head Office books—

	£	s.	d.
Cash received from Bedford Branch	5,441	6	6
Expenses of Bedford Branch	236	16	2

This example is illustrated on pages 280 and 281.

Branch Adjustment Accounts.

Hitherto we have dealt with the "two-column" method of recording the goods sent to branches—at selling price and at cost. There is another method, which is quite common in practice, known as the "Branch Adjustment Account" method. Under this system the goods are entered in the head office books at selling prices only. This dispenses with the double columns, but it can hardly be regarded as so satisfactory a method as the one explained above. The principal point to be watched is again the matter of deleting the unearned profit on stock at balancing time. The method itself may be explained by tabulating its main features—

1. A Branch Account, a Branch Adjustment Account,

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Dr. **BEDFORD BRANCH ACCOUNT (Example " B ")** *Cr.*

			Selling Prices			Adjusted Prices							Selling Prices			Adjusted Prices		
1936			£	s.	d.	£	s.	d.	1936				£	s.	d.	£	s.	d.
June 1	To Stock-in-Trade	b/d	284	4	4	213	3	3	June 1–30	By Cash Sales .	C.B.		2,300	10	8	2,300	10	8
,, 1–30	,, Goods supplied from Head Office	B.S.J.	4,824	8	8	3,618	6	6	,, 1–30	,, Credit Sales . (see Branch Debtors' Account)	Jnl.		2,495	12	4	2,495	12	4
,, 30	,, Gross Profit .	c/d				1,199	–	9										
									,, 30	,, Stock-in-Trade .	c/d		312	10	–	234	7	6
			£5,108	13	–	£5,030	10	6					£5,108	13	–	£5,030	10	6
June 1–30	To Expenses for the Month .	C.B.				236	16	2	June 30	By Gross Profit .	b/d					1,199	–	9
,, 30	,, Net Profit for the Month transferred to P.& L.A/c	Jnl.				962	4	7										
						£1,199	–	9								£1,199	–	9
July 1	To Stock-in-Trade	b/d	312	10	–	234	7	6										

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BEDFORD BRANCH DEBTORS' ACCOUNT

Dr. *Cr.*

1936			£	s.	d.	1936			£	s.	d.
June 1	To Balance outstanding at this date	b/d	2,320	8	8	June 1–30	By Cash collected during Month	C.B.	3,140	15	10
,, 1–30	,, Credit Sales (see Branch A/c)	Jnl.	2,495	12	4	,, 1–30	,, Bad Debts written off	Jnl.	28	6	–
						,, 1–30	,, Discounts allowed	Jnl.	88	3	5
						,, 30	,, Balance outstanding carried down		1,558	15	9
			£4,816	1	–				£4,816	1	–
July 1	To Balance outstanding at this date	b/d	1,558	15	9						

and a Branch Profit and Loss Account are opened for each branch.

2. The goods sent to the branch are debited at selling price to the Branch Account and credited, also at selling price, to the "Goods sent to Branches Account."

3. The cash remittances during the year are treated in the usual manner and credited to the Branch Account. The stock at the end of the year is carried down in the Branch Account at selling price.

4. At the end of the year, or other chosen period, the gross profit contained in the "Goods sent to Branches Account" is transferred from that account to the credit of the Branch Adjustment Account.

5. Against the gross profit credited in the Branch Adjustment Account is set off a reserve equal to the "loading" in the closing stock. The reserve is then carried down to the credit of the Branch Adjustment Account as the opening entry for the new period.

6. The balance remaining to the credit of the Branch Adjustment Account now represents gross profit on sales (not gross profit on goods sent to branches), and is transferred to the credit of the Branch Profit and Loss Account.

EXAMPLE. The foregoing tabulation should now be re-examined in conjunction with the following illustration. It should be observed that the net effect of the procedure is—

(*a*) All entries are made on a selling price basis.

(*b*) Only at the end of the selected accounting period does the Branch Adjustment Account come into play. It is then used to reduce stocks to cost price.

(*c*) After the closing of the books, two balances remain, one is the debit on Branch Account, representing stock at the branch at selling price; and the other is the credit on Branch Adjustment Account, representing the reserve against such stock.

The head office of the Popular Stores Co., Ltd., has

these entries in its books relating to its Norwich Branch—

	£	s.	d.
Goods sent to Norwich at Selling Prices (33⅓% on Cost) on 1st January	3,240	6	8
Goods sent to Norwich during Month . .	3,120	10	10
Cash remitted by Branch for Month . .	4,980	8	4
Stock at 31st January at Selling Price . .	1,380	9	2
Salaries at Norwich Branch	130	9	–
Rent and Rates—Norwich Branch . . .	50	6	–
General Expenses—Norwich Branch . . .	84	10	–

The accounts illustrating the foregoing are given on pages 284 and 285.

Independent Branches.

Reference was made earlier in the chapter to the fact that companies may find it more convenient to treat their branches as completely independent concerns.

At the end of the year it will be necessary to incorporate the branches' assets and liabilities in the main Balance Sheet. This is effected by taking the trial balance forwarded by each branch and the head office trial balance, and then adding each branch asset and liability to its corresponding item in the head office trial balance. When this has been carried out, it will be found that all items in the branch trial balances have been disposed of except the "Head Office Current Accounts." But the "Branch Office Current Accounts" in the head office trial balance form the counterpart of each "Head Office" account in the branch books. These items are, therefore, treated as *contras* and eliminated; the head office trial balance should then agree, and the preparation of the consolidated Balance Sheet proceeds in the usual manner.

No illustration is given of this consolidation of trial balances, because the same principle is involved in Foreign Branch Accounts, which forms the subject-matter of the next chapter. The amalgamation of trial balances will be found explained fully therein.

THE POPULAR STORES CO., LTD.

NORWICH BRANCH ACCOUNT

Dr. *Cr.*

1936			£	s.	d.	1936			£	s.	d.
Jan. 1	To Goods sent from Head Office on Opening of Branch	B.S.J.	3,240	6	8	Jan. 1–31	By Cash received from Branch . . . (Sales for Month)	C.B.	4,980	8	4
,, 1–31	,, Goods sent from Head Office during the Month . .	B.S.J.	3,120	10	10	,, 31	,, Stock-in-Trade carried down at Selling Price . . .	c/d	1,380	9	2
			£6,360	17	6				£6,360	17	6
Feb. 1	To Stock-in-Trade at Selling Price. .	b/d	1,380	9	2						

(EXTRACT FROM) GOODS SENT TO BRANCHES' ACCOUNT

Dr. *Cr.*

1936			£	s.	d.	1936			£	s.	d.
Jan. 31	To Transfer of Gross Profit to Norwich Branch Adjustment Account	Jnl.	1,590	4	4	Jan. 1	By Goods sent to Norwith Branch (at Selling Prices) . . .	B.S.J.	3,240	6	8
,, 31	,, Transfer of Balance to Trading Account .	Jnl.	4,770	13	2	,, 1–31	,, Goods sent to Norwich Branch (at Selling Prices) . . .	B.S.J.	3,120	10	10
			£6,360	17	6				£6,360	17	6

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NORWICH BRANCH ADJUSTMENT ACCOUNT

Dr. *Cr.*

1936			£	s.	d.	1936			£	s.	d.
Jan. 31	To Reserve carried down equal to Profit contained in closing Stock-in-Trade (one-quarter of £1,380 9s. 2d.)	c/d	345	2	3	Jan. 31	By Transfer of Gross Profit from "Goods sent to Branches" Account	Jnl.	1,590	4	4
,, 31	,, Transfer of Gross Profit to Norwich Branch Profit and Loss A/c	Jnl.	1,245	2	1						
			£1,590	4	4				£1,590	4	4
						Feb. 1	By Reserve brought down.	b/d	345	2	3

NORWICH BRANCH PROFIT AND LOSS ACCOUNT

Dr. *Cr.*

1936			£	s.	d.	1936			£	s.	d.
Jan. 31	To Salaries	C.B.	130	9	–	Jan. 31	By Gross Profit for Month per Branch Adjustment Account	Jnl.	1,245	2	1
,, 31	,, Rent and Rates	C.B.	50	6	–						
,, 31	,, General Expenses	C.B.	84	10	–						
,, 31	,, Net Profit transferred to Profit and Loss Account	Jnl.	979	17	1						
			£1,245	2	1				£1,245	2	1

Goods sent to Branches

It will be observed that the balance on "Goods sent to Branches" has been transferred, in the examples given in this chapter, to Trading Account—irrespective of whether the goods have been sold or not. It is often contended that this practice is unsound in theory, and the alternative method which is sometimes put forward is therefore explained in an Appendix.

SELF-EXAMINATION QUESTIONS. XXI

1. Give a brief description of a method of keeping branch accounts designed to maintain a close control over the stock-in-trade as well as the cash.

2. The X Y Z Co. sends goods to its Leeds Branch during July valued at £4,982 16s. 6d., representing cost plus 15 per cent. The branch sales amount to £4,784 2s. 8d., and the expenses to £148 2s. 3d. Set out the branch account as it would appear in the head office books under the double column method. The cash takings were remitted to the head office immediately on receipt.

3. Draft a report to a board of directors as to the control, accounts, and records you would recommend for their multiple shop business, which has 500 branches. The company deals in four commodities only, on each of which there is a definite gross profit percentage.

4. The Surrey Dairy Co., Ltd., supplied its branches during the six months ended 31st December with the following goods, and paid cash on their account as under—

Branch	K	P	Q
	£	£	£
Goods to Depots	700	600	900
Returns from Depots . . .	10	9	21
Rates and Taxes paid by Head Office	31	29	40
Wages and Expenses paid by Head Office	39	40	45
The Depot Sales were . . .	1,000	900	1,350
Returns from customers were . .	50	36	60
Depots collected Cash from customers and dispatched same to Head Office	850	720	1,200
The Stocks on hand at 31st Dec. were	100	120	110

Frame the proper Journal entries to record the above transactions in the head office books, and write up in the head office Ledger the accounts necessary to show the profit or loss made by each branch and the balance due at each branch from Sundry Debtors.—(*Civil Service, 2nd Division Clerks.*)

CHAPTER XXII

FOREIGN BRANCH ACCOUNTS

THE accounts of foreign branches are usually self-contained and independent of the home head office. The link between the two consists of the Current Accounts of the two offices with each other. There may be more than one division of the Current Account between the offices, and the secretary is at liberty to break it up to suit the particular requirements of his company's business. If, therefore, the Branch Account relates to a rubber plantation abroad, it may be found convenient to analyse the inter-office transactions as between—

Branch Capital Expenditure Account;

Branch Remittances Account;

Branch Advances Account; and so on.

In other cases—particularly retailing branches—it may be found quite sufficient to keep a Branch Account or a Branch Adjustment Account, and no other.

Head Office Accounts.

There is the same latitude with regard to the head office accounts in the branch books as in the opposite case discussed above. As long as the nature of the head office accounts are borne in mind it makes no difference whether they are incorporated in one Head Office Current Account, or whether they are kept subdivided. The usual subdivisions encountered are "Head Office Advances Account," "Remittances to Head Office," and "Head Office Current Account."

The head office account or accounts in the branch books should be looked upon as the "Capital Account" or the amount invested by the head office in the branch. If this point is appreciated, then no difficulty should

arise and any danger of omitting, or of including incorrectly, any of the head office accounts in the closing Trial Balance will be obviated.

The Branch Account or Accounts in the head office books may be regarded as the book value of an investment in the branch business. If this point is considered in conjunction with that contained in the paragraph above, it will be seen at once that the inter-office accounts—from the point of view of the company as a whole—are nothing more than *contras*. Subject to a minor matter connected with goods and cash in transit, the head office accounts and the branch accounts may, therefore, be set off against one another and cancelled out when the Trial Balance of the whole business is prepared.

Cash and Goods in Transit.

At the close of a company's financial period the secretary may find that the Branch Trial Balances include balances on the head office account which disagree with his Ledger. This may be due to some such cause as the following—

(*a*) Produce or remittances from branches abroad which have not yet reached the head office.

(*b*) Cash in respect of sales made by home branches of a retailing company not having reached the head office banking account.

(*c*) Cash advances, goods for resale, or capital assets sent out to home or foreign branches by the head office, but in transit at balancing time.

Whatever the cause of the disagreement between the accounts, it is essential that they should be reconciled before the final Trial Balance is prepared. As a general principle to follow it is recommended that the reconciliation should be effected on the following lines—

1. Decide which of the accounts represents the more correct view of the company's affairs.

2. Diminish or increase the less correct account by the difference.

3. Treat the difference as a separate asset, liability, or revenue item in the final Trial Balance.

It is impossible to enumerate every type of item which necessitates the reconciliation of head office and branch accounts, but the following example illustrates the principle set out above. It will be noticed that the adjustments differ considerably in their nature, and that they result in amendments both to the head office and to the Branch Account. Particular attention is drawn to the treatment of the goods in transit abroad and to England.

EXAMPLE. On 30th June, 1936, the secretary of the Colonial Produce Co., Ltd., is called upon to prepare a consolidated Trial Balance from the head office and Sekondi Trial Balances which are laid before him in the following form—

HEAD OFFICE TRIAL BALANCE—30th JUNE, 1936

	Dr. £	*Cr.* £
Capital Account		250,000
Plant and Machinery	25,000	
Buildings	50,000	
Debtors	100,000	
Creditors		80,000
Cash	25,000	
Sekondi Branch Account	19,500	
Payment made to Sekondi Assistant Manager	500	
Stock-in-trade	140,000	
Head Office Profit and Loss Account (per separate account)		25,000
Sekondi Branch Profit and Loss Account for the Half-year ended 31st December, 1935		5,000
£	360,000	360,000

Note. The head office sent textiles and other saleable goods, value £5,000, to Sekondi on 28th June, and also made a payment of £500 in respect of salary to the assistant manager home on leave.

SEKONDI BRANCH TRIAL BALANCE—30th JUNE, 1936

	Dr. £	*Cr.* £
Head Office Account		12,000
Stocks of Cocoa up Country	4,200	
Freehold Property	1,800	
Stocks of Textiles and Goods for Resale	2,500	
Cash at Bank—Accra	800	
Profit and Loss Account for the Half-year to date		2,500
Advances to Natives	5,200	
Note. The Branch shipped coffee to the Liverpool brokers on 29th June to the value of £2,250 and made a payment of £250 on behalf of the head office to a creditor in Dunkwa.		
	£14,500	£14,500

Before preparing the consolidated Trial Balance the secretary might possibly decide to make Journal entries in respect of the items "in transit" referred to by way of footnotes to the Trial Balances. As these Journal entries serve to illustrate the application of the principles enumerated, they are set out below—

1936			£	£
June 30	Goods in Transit to Branch Account	*Dr.*	5,000	
	To Sekondi Branch Account			5,000
	Adjustment in respect of Textiles and other Goods sent to Sekondi on 28th June and in transit on 30th June.			
,, 30	Sekondi Branch Profit and Loss Account	*Dr.*	500	
	To "Payment made to Assistant Manager"			500
	Transfer of Salary paid to Assistant Manager whilst on leave.			
,, 30	X (Creditor in Creditors' Ledger)	*Dr.*	250	
	To Sekondi Branch Account			250
	For payment made to a Head Office Creditor in Dunkwa by Branch.			

The effect of the foregoing entries may be summarized as shown on page 291, and the combined Trial Balance of the head office and the Sekondi branch may now be set up. It will be found set out fully on page 292.

	Branch Account in H.O. Books	Head Office Account in Branch Books
	£	£
Balance per Trial Balance . . .	19,500	12,000
Adjustment of—		
(*a*) Goods in Transit to Branch and Coffee in Transit to Liverpool .	5,000	2,250
(*b*) Charge to Branch Profit and Loss of Salary paid to Assistant Manager	Nil	Nil
[*As the Branch Profit is to be transferred to Head Office there is no point in charging this item to Branch Account and then taking it back on charge.*]		
	14,500	14,250
(*c*) Deduction from Creditors in Head Office Books (paid by Branch) .	250	
Balances for inclusion in Trial Balance .	£14,250	£14,250

Foreign Currency Accounts.

We must now consider the accounts of a company having branches in a foreign country, and the points connected with the conversion of currency balances. If the branches are situated in a foreign country in which the currency is stable, then the conversion of the Currency Trial Balance at the end of the year presents no difficulty whatever. Each item is converted at the rate ruling at the year-end, and no difference in exchange of any importance arises. It is likely, of course, that a discrepancy of a few pounds will occur, but a minor adjustment to the Branch Current Account will rectify the matter.

In the case of foreign branches in countries having fluctuating currencies, the differences on exchange are likely to amount to a considerable figure. It is therefore arranged that the losses or profits shall be allocated and adjusted in the appropriate section or sections of the annual accounts to which they relate. For this

THE COLONIAL PRODUCE CO., LTD.
TRIAL BALANCE as at 30th JUNE, 1936

	Head Office		Sekondi		Net Balances	
	£	£	£	£	£	£
Capital Account	—	250,000	—	—	—	250,000
Plant and Machinery	25,000	—	—	—	25,000	—
Buildings	50,000	—	1,800	—	51,800	—
Debtors	100,000	—	—	—	100,000	—
Advances to Natives	—	—	5,200	—	5,200	—
Creditors	—	79,750	—	—	—	79,750
Cash at Bankers	25,000	—	800	—	25,800	—
Sekondi Branch and Head Office Accounts	14,250	—	—	14,250	Nil	Nil
Stock-in-trade	140,000	—	6,700	—	146,700	—
Head Office Profit and Loss Account	—	25,000	—	—	—	25,000
Sekondi Branch Profit and Loss Account	—	4,500	—	2,500	—	7,000
Goods in Transit	5,000	—	2,250	—	7,250	—
£	359,250	359,250	16,750	16,750	361,750	361,750

purpose the various items appearing in the branch's accounts are converted as follows—

(*a*) Fixed Assets. At the rate ruling at the date of purchase.

(*b*) Minor Additions to Fixed Assets. At the average rate ruling for the year.

(*c*) Fixed Liabilities. At the rate ruling at the date they were incurred.

(*d*) Floating Assets and Current Liabilities. At the rate ruling at the date of closing the accounts, but the opening stock is valued at the rate at which it appeared in the preceding accounts.

(*e*) Profit and Loss Account Items (or the Balance of Profit and Loss Account). At the average rate for the year.

(*f*) Remittances. At the actual rate of the date when made.

The exact effect of, and the reasons underlying the adoption of, these varying rates may be seen from a comparison of the treatment accorded to the inter-office accounts under the two sets of circumstances. We therefore proceed to consider the conversion of the head office account firstly in the case of a stable currency country, and then in the case of a country whose currency is liable to sudden fluctuations.

Head Office Accounts.

As the first example deals with a fairly fixed currency, we convert all items at some convenient rate approximating as nearly as possible to the average rate ruling throughout the year. Although in practice it is often found convenient to adopt the closing rate. The student may wonder why an average rate is necessary in the case of a stable exchange. The answer is that even the most stable exchanges are liable to slight changes, generally of a seasonal character, and that a comparatively small profit or loss is bound to arise in every case.

TRIAL BALANCE—(BEFORE CONVERSION)

	Head Office						Urania Branch			
	Dr.			*Cr.*			*Dr.*		*Cr.*	
	£	*s.*	*d.*	£	*s.*	*d.*	*Fr.*	*C.*	*Fr.*	*C.*
Capital Account				200,000	–	–				
Creditors and Accrued Expenses				45,298	10	3			224,678	56
Bills Payable									2,858,681	00
Debtors and Payments in Advance	150,483	6	3				1,380,360	12		
Mortgages on Properties as at 1st July, 1934				25,000	–	–			100,000	00
Freehold and Leasehold Properties	75,000	–	–				1,250,000	00		
Stock-in-trade at 1st July, 1934	27,300	1	4				342,007	90		
Purchases	182,480	6	–				1,307,820	45		
Sales				214,310	9	6			2,320,410	70
Wages and Salaries	24,898	6	3				1,400,190	25		
Advertising and Publicity	1,200	6	8							
Carriage and Expenses of Distribution	2,100	3	9				200,490	60		
General Expenses	4,800	7	6				186,290	35		
Cash at Bankers and in Hand	8,225	1	4				250,100	75		
Head Office Account and Urania Branch Account	22,419	6	8						2,242,830	66
Remittance Account				14,298	6	–	1,429,340	50		
	£498,907	5	9	£498,907	5	9	7,746,600	92	7,746,600	92

In view of the fact that the post-war period has witnessed many sudden, and sometimes unexpected, transitions from stable to fluctuating currencies and vice versa, it seems desirable to base our illustrations on an imaginary country. We will assume, therefore, that the branch with which we are dealing is situated in Urania and that the currency is the Uranian franc. The Trial Balances of the head office and the Uranian branch as at 30th June, 1935, are given on page 294. Particular attention is drawn to the fact that the Branch Account appears in the head office books at £22,419 6s. 8d. and the Remittance Account balance at £14,298 6s.

EXAMPLE "A." The Conversion of the Trial Balances on the assumption that the Uranian franc has been approximately stable throughout the year at 100 to the £ is illustrated on page 296.

Profit on Remittances.

It is not essential to keep a separate Remittance Account and it is quite common, in fact, to find it incorporated with the Branch Account. There are advantages in keeping a separate account, however, and as it entails very little additional work it is a course which can be recommended. It distinguishes the adventitious profits or losses arising from the purchases and sales of sterling or of currency drafts, from the actual results of the trading abroad. In addition, it provides a separate medium for recording forward financing transactions. Some companies permit their managers abroad to use discretion in the purchase of sterling for transmission home. In such cases the manager may often seize an opportunity of covering the remittances which he expects to make during the next few weeks or months by buying forward. Conversely, the head office will avail itself of a favourable rate to cover future advances to the branch. It is the profit or loss on these

EXAMPLE "A"—CONVERSION OF STABLE EXCHANGE

	Head Office						Urania Branch					
	Dr.			*Cr.*			*Dr.*			*Cr.*		
	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*	£	*s.*	*d.*
Capital Account				200,000	–	–						
Creditors and Accrued Expenses				45,298	10	3				2,246	15	9
Bills Payable										28,586	16	2
Debtors and Payments in Advance	150,483	6	3				13,803	12	–			
Mortgages on Properties				25,000	–	–				1,000	–	–
Freehold and Leasehold Properties	75,000	–	–				12,500	–	–			
Stock-in-trade at 1st July, 1934	27,300	1	4				3,420	1	9			
Purchases	182,480	6	–				13,078	4	1			
Sales				214,310	9	6				23,204	2	2
Wages and Salaries	24,898	6	3				14,001	18	–			
Advertising and Publicity	1,200	6	8									
Carriage and Expenses of Distribution	2,100	3	9				2,004	18	1			
General Expenses	4,800	7	6				1,862	18	–			
Cash at Bankers and in Hand	8,225	1	4				2,501	–	2			
Head Office and Urania Branch Accounts	22,419	6	8							22,419	6	8
Remittance Account				14,298	6	–	14,298	6	–			
Differences on Exchange—												
Profit on Head Office Account										8	19	5
Profit on Remittances										4	17	11
	£498,907	5	9	£498,907	5	9	£77,470	18	1	£77,470	18	1

financing transactions that is kept apart from the trading operations by opening a distinct Remittance Account.

Conversion of Fluctuating Account.

For the purpose of illustrating the conversion of the Trial Balance of a branch whose trading is subject to a fluctuating currency, we will adapt the accounts of the Uranian company used in Example "A." The alternative treatment is given on page 298, headed Example "B." In this case we are informed that the currency rates were—

1. At 1st July, 1934 . . . . . 100·00
2. At 30th June, 1935 . . . . . 105·00
3. Average rate for the year . . . 102·00

In addition, we find that one of the buildings abroad was purchased during the year for frs. 250,000 when the rate was 104. The other properties were purchased in 1930 at 106 and were mortgaged at the same rate. Applying the table given on page 293 we convert the Trial Balance on these lines—

(*a*) Fixed Assets. At 106·00 except the additions, which will be converted at 104·00.
(*b*) Fixed Liabilities. At 106·00.
(*c*) Floating Assets and Liabilities. At 105·00 with the exception of the opening stock, which is valued at 100·00.
(*d*) Profit and Loss Items. At 102·00.

Balance Sheet and Profit and Loss Account.

As soon as the branch Trial Balance has been converted and incorporated with the head office figures, the preparation of the company's Balance Sheet proceeds along the usual lines. No special points arise in connection with this matter, and there is, therefore, no need to illustrate the actual accounts.

The branch Trading and Profit and Loss Account is usually kept distinct from the head office Revenue Account, the net profit or net loss only being carried to the main Profit and Loss Account.

EXAMPLE "B"—CONVERSION OF FLUCTUATING EXCHANGE

	Rate	Currency		Sterling	
		Dr.	*Cr.*	*Dr.*	*Cr.*
		Fr. C.	*Fr.* C.	£ s. d.	£ s. d.
Creditors and Accrued Expenses	105		224,678 56		2,139 16 –
Bills Payable	105		2,858,681 00		27,225 10 9
Debtors and Payments in Advance	105	1,380,360 12		13,146 5 8	
Mortgages on Properties	106		100,000 00		943 8 –
Freehold and Leasehold Properties	106	1,000,000 00		9,433 19 3	
Freehold and Leasehold Properties purchased during year	104	250,000 00		2,403 17 –	
Stock-in-trade at 1st July, 1934	100	342,007 90		3,420 1 9	
Purchases	102	1,307,820 45		12,821 15 6	
Sales	102		2,320,410 70		22,749 2 6
Wages and Salaries	102	1,400,190 25		13,727 7 1	
Carriage and Expenses of Distribution	102	200,490 60		1,965 12 –	
General Expenses	102	186,290 35		1,826 7 6	
Cash at Bankers and in Hand	105	250,100 75		2,381 18 3	
				61,127 4 –	53,057 17 3
Head Office Account	—		2,242,830 66		22,419 6 8
Remittance Account	—	1,429,340 50		14,298 6 –	
Difference—Loss on Exchange				51 13 11	
		7,746,600 92	7,746,600 92	£75,477 3 11	£75,477 3 11

The secretary will probably prefer to show separately, as insets, the stocks held in England and those held abroad or in transit. Similarly, the cash at banks at home should be distinguished from the balances with bankers abroad. These points and others which are common to all Balance Sheets will be discussed in greater detail in Section IV.

SELF-EXAMINATION QUESTIONS. XXII

1. A company, having its head office in London, owns a factory in South Africa. During the year £10,000 in cash has been remitted from London to the factory, and bills for £5,000, drawn by the manager in South Africa on the head office, have been accepted. At the end of the year it is found that there is a loss on the factory of £2,000 which is transferred to the head office. Show the entries in the head office books recording these transactions.—(*Chartered Accountants.*)

2. Messrs. Pernet Ducher & Co., Ltd., of London, have a branch office in a South American republic where the exchange fluctuations are considerable. The books of the branch are kept in local currency only, and at the close of each financial year a Trial Balance, Profit and Loss Account and Balance Sheet are sent to the London office. Describe briefly how you would amalgamate the branch figures with those of the head

SHANGHAI TRIAL BALANCE—31st DECEMBER, 1930

	Dr.	*Cr.*
	Taels	Taels
Head Office Account		92,680
Stock at 1st January, 1930	32,106	
Freehold Land and Buildings (bought at 1s. 8d.)	18,000	
Purchases	44,028	
Sales		67,049
Sundry Debtors	27,423	
Sundry Creditors		13,760
Rates and Taxes	804	
Carriage and Freight	3,201	
Sundry Expenses	352	
Salaries	3,104	
Wages	8,412	
Cash at Bankers	36,059	
	173,489	173,489

office. At what rates would you convert (1) the Profit and Loss Account balance, (2) the floating assets, (3) the fixed assets, and (4) the remittances from London.

3. The Sumatra Trading Co., Ltd., permits its local manager to remit the proceeds of his trading at his discretion, and he is also allowed to cover his arrangements by buying sterling forward. The directors ask your views on the point, particularly as to the desirability of amplifying or modifying the head office accounts relating to the branch.

4. The trial balance shown on page 299 is to be converted into sterling. The rate of exchange for the Tael was 1s. 6d. at 31st December, 1930, and 1s. 9d. at 31st December, 1929, whilst the average rate for the year was 1s. 7d.

CHAPTER XXIII

HIRE-PURCHASE ACCOUNTS

THE rapid increase in hire-purchase trading during recent years necessitates careful study, on the part of the secretary, of the accounts which are employed to record such transactions.

There are several "systems" of hire-purchase accounts in use, and new methods are evolved from day to day to deal with the constantly increasing ramifications of hire-purchase agreements. The secretary who devises a new method suited to his company's particular requirements need not fear that he is transgressing any hard and fast theories. Provided always that he frames his system in strict accordance with what may be termed the "elements" of the hiring agreement, his method is not likely to be criticized. The reason for this peculiar elasticity of procedure is that more and more trades are experimenting with the utilization of "consumer credit." It is not to be wondered at, therefore, that variations in hire-purchase accounts are adopted to meet the peculiar needs of each trade, as and when it commences to avail itself of the hire-purchase system of disposing of its commodities.

The Buyer's Record.

The student is recommended to study the buyer's records first. When he has grasped the entries made by the secretary of the purchasing company, he will find it simpler to understand the procedure followed by the selling company.

In practically every case the purchase of goods by instalments forms the subject-matter of a written agreement. The secretary should therefore make this the basis for his book entries, and tabulate the principal

clauses carefully somewhat on the lines indicated for Royalty Agreements. This done, it will be found that the total purchase price consists of two parts—the actual cash price, and the interest content. Each part demands different treatment, and the treatment varies with the nature of the agreement. In particular, a distinction must be drawn between instalment buying and hire purchase.

Instalment Buying.

Until quite recently, the dividing line between buying by instalments and buying by means of a hiring agreement was much more marked than it is now. In the last two or three years the instalment plan has been almost entirely discarded, and even in those cases in which it survives it is common to insert a great number of the protective clauses usually found in the pure hire purchase agreement. The result is that the two methods are now almost parallel in their terms and in their effect. The underlying difference of principle between the two is that the property in the goods passes at once under the instalment plan, whilst under the other the goods remain the property of the seller until the final payment has been made. It follows that the purchaser rightly brings into the books the full cash price of the asset if the agreement is one for buying by instalments. He also enters up, as a liability, the full amount of the debt due to the supplier.

The treatment of the interest on the outstanding instalments often varies, but two main alternative methods are these—

(*a*) The interest on the outstanding principal is calculated at each "rest," debited to "Interest," and credited to the account of the vendor. The vendor is then given a cheque for the instalment due plus the interest.

(*b*) The interest for the whole period is calculated

Entries in the Books of the Provincial Haulage Co., Ltd. (Example "A")

Dr. **THE LORRY MANUFACTURING CO., LTD.** *Cr.*

1938			£	s.	d.	1938			£	s.	d.
Jan. 1	To Deposit	C.B.	500	–	–	Jan. 1	By 10 Lorries at £250 each	Jnl.	2,500	–	–
June 30	,, Cash	C.B.	550	–	–	June 30	,, Int. on £2,000 at 5% p.a.	Jnl.	50	–	–
Dec. 31	,, Cash	C.B.	537	10	–	Dec. 31	,, Int. on £1,500 at 5% p.a.	Jnl.	37	10	–
1939						1939					
June 30	,, Cash	C.B.	525	–	–	June 30	By Int. on £1,000 at 5% p.a.	Jnl.	25	–	–
Dec. 31	,, Cash	C.B.	512	10	–	Dec. 31	,, Int. on £500 at 5% p.a.	Jnl.	12	10	–
			£2,625	–	–				£2,625	–	–

Dr. **INTEREST ACCOUNT** *Cr.*

1938			£	s.	d.	1938			£	s.	d.
June 30	To Int. on £2,000 for 6 mos.	Jnl.	50	–	–	Dec. 31	By Transfer to Profit and Loss Account	Jnl.	87	10	–
Dec. 31	,, Int. on £1,500 for 6 mos.	Jnl.	37	10	–						
			£87	10	–				87	10	–
1939						1939					
June 30	To Int. on £1,000 for 6 mos.	Jnl.	25	–	–	Dec. 31	By Transfer to Profit and Loss Account	Jnl.	37	10	–
Dec. 31	,, Int. on £500 for 6 mos.	Jnl.	12	10	–						
			£37	10	–				£37	10	–

Entries in the Books of the Provincial Haulage Co., Ltd. (Example "B")

Dr. **THE LORRY MANUFACTURING CO., LTD.** *Cr.*

1938			£	s.	d.	1938			£	s.	d.
Jan. 1	To Deposit	C.B.	500	–	–	Jan. 1	By Purchase Price of 10 Lorries, including Interest on Instalments	Jnl.	2,625	–	–
June 30	,, Cash	C.B.	550	–	–						
Dec. 31	,, Cash	C.B.	537	10	–						
1939											
June 30	To Cash	C.B.	525	–	–						
Dec. 31	,, Cash	C.B.	512	10	–						
			£2,625	–	–				£2,625	–	–

Dr. **INTEREST SUSPENSE ACCOUNT** *Cr.*

1938			£	s.	d.	1938			£	s.	d.
Jan. 1	To Interest on Instalments on 10 Lorries	Jnl.	125	–	–	Dec. 31	By Transfer to Profit and Loss Account	Jnl.	87	10	–
						,, 31	,, Balance	c/d	37	10	–
			£125	–	–				£125	–	–
1939						1939					
Jan. 1	To Balance	b/d	37	10	–	Dec. 31	By Transfer to Profit and Loss Account	Jnl.	37	10	–
			£37	10	–				£37	10	–

Entries in Books of the Provincial Haulage Co., Ltd. (*Contd.*)

Dr. **LORRIES ACCOUNT (applicable to Examples "A" and "B")** *Cr.*

1938			£	s.	d.	1938			£	s.	d.
Jan. 1	To 10 Lorries purchased this day	Jnl.	2,500	–	–	Dec. 31	By Depreciation written off at 10%	Jnl.	250	–	–
						,, 31	,, Balance	c/d	2,250	–	–
			£2,500	–	–				£2,500	–	–
1939						1939					
Jan. 1	To Balance	b/d	2,250	–	–	Dec. 31	By Depreciation written off at 10%	Jnl.	225	–	–
						,, 31	,, Balance	c/d	2,025	–	–
			£2,250	–	–				£2,250	–	–
1940											
Jan. 1	To Balance	b/d	2,025	–	–						

at the outset and debited to "Interest Suspense Account" and credited to the vendor. The instalments paid are debited to the vendor's account as usual, and a proportionate part of the "Interest Suspense Account" is written off the Profit and Loss Account at the end of each year or other agreed "rest."

EXAMPLE "A." The Provincial Haulage Co., Ltd., buys 10 motor lorries on 1st January, 1938 for £250 each from the Lorry Manufacturing Co., Ltd. It is agreed that a deposit of £500 shall be made and that interest at 5 per cent per annum shall be added to the balance at half-yearly rests. The half-yearly payments are fixed at £500 plus the interest to date. It is required to show the entries in the buying company's books calculating the interest at each rest and writing off depreciation annually at 10 per cent.

EXAMPLE "B." Adopting the same figures as given in Example "A" it is required to show the entries in the books, using the Interest Suspense Method.

The illustrations of these two examples will be found set out on pages 303 to 305.

Equal Instalments.

Before leaving the subject of instalment-buying one minor matter remains to be mentioned. For the sake of convenience the secretary of the purchasing company may ask the selling company to agree to the calculation of the total price in such a way that the annual or semi-annual instalments may be equal in amount. This practice is quite common, but the book entries are no different from those already illustrated.

EXAMPLE. The Provincial Haulage Company buys 10 lorries from the Lorry Manufacturing Co., Ltd., for £2,164 14s. 10d. cash, plus interest at 5 per cent on the outstanding balances, payable in five equal annual instalments of £500 each.

A table for the use of the purchasing company,

intended to serve as a basis on which the secretary can frame his entries, is set out below—

Year	Balance to Credit of Selling Co.	Interest at 5%	Total	Instalment Paid	Balance Carried Forward	Depreciation at 10% p.a.
	£	£	£	£	£	£
1	2,164·7416	108·2370	2,272·9786	500	1,772·9786	216·474
2	1,772·9786	88·6489	1,861·6275	500	1,361·6275	194·826
3	1,361·6275	68·0813	1,429·7088	500	929·7088	175·344
4	929·7088	46·4854	976·1942	500	476·1942	157·809
5	476·1942	23·8058	500·0000	500	*nil*	142·028

Hire-Purchase Entries.

In the hire-purchase agreement the secretary of the buying company must first ascertain the interest content of each instalment. This interest, which is termed the "Hire," is written off to Profit and Loss Account, whilst the balance is debited to the asset account. In this way the capital value of the asset gradually increases until, at the end of the period, it amounts to the cash value less any depreciation which has been written off.

Depreciation is written off the full cash value of the asset irrespective of the fact that only one or two instalments may have been paid. The secretary may find that certain authorities advise that it is incorrect to depreciate an asset which does not actually belong to the company, but the argument is an academical one, and need not be accepted in practice.

EXAMPLE. The Talking Picture Machine Co., Ltd., sells four machines on 1st January, 1935, to the Elysium Cinemas, Ltd., for £6,000 payable £1,000 with order and five annual instalments of £1,000. The interest is included in the price and has been calculated at 5 per cent. From interest tables the secretary of the Elysium Cinemas, Ltd., finds the cash value to be £5,329 9s. 8d. Depreciation is to be charged at 10 per cent per annum. The accounts are set out on pages 308–310.

Entries in the Books of Elysium Cinemas, Ltd.

Dr. **THE TALKING PICTURE MACHINE CO., LTD.** *Cr.*

1935			£	s.	d.	£	s	d.	1935			£	s.	d.	£	s.	d.
Jan. 1	To Cash Deposit paid.	C.B.	1,000	–	–				Jan. 1	By T.P. Machine A/c	Jnl.				1,000	–	–
Dec. 31	To Cash—1st Instlmt.	C.B.	1,000	–	–				Dec. 31	,, T.P. Machine A/c	Jnl.	783	10	6			
									,, 31	,, Machine Hire A/c	Jnl.	216	9	6			
															1,000	–	–
1936									1936								
Dec. 31	To Cash—2nd Instlmt.	C.B.	1,000	–	–				Dec. 31	By T.P. Machine A/c	Jnl.	822	14	1			
									,, 31	,, Machine Hire A/c	Jnl.	177	5	11			
															1,000	–	–
1937									1937								
Dec. 31	To Cash—3rd Instlmt.	C.B.	1,000	–	–				Dec. 31	By T.P. Machine A/c	Jnl.	863	16	9			
									,, 31	,, Machine Hire A/c	Jnl.	136	3	3			
															1,000	–	–
1938									1938								
Dec. 31	To Cash—4th Instlmt.	C.B.	1,000	–	–				Dec. 31	By T.P. Machine A/c	Jnl.	907	–	7			
									,, 31	,, Machine Hire A/c	Jnl.	92	19	5			
															1,000	–	–
1939									1939								
Dec. 31	To Cash—5th Instlmt.	C.B.	1,000	–	–				Dec. 31	By T.P. Machine A/c	Jnl.	952	7	9			
									,, 31	,, Machine Hire A/c	Jnl.	47	12	3			
						6,000	–	–							1,000	–	–
						£6,000	–	–							£6,000	–	–

Entries in the Books of the Elysium Cinemas, Ltd. (*Contd.*)

Dr. **THE TALKING PICTURES MACHINE ACCOUNT** *Cr.*

			£	s.	d.				£	s.	d.
1935 Jan. 1	To Deposit paid to T.P. Machine Co., Ltd.	Jnl.	1,000	–	–	1935 Dec. 31	By Depreciation at 10% p.a. on £5,329 9s. 8d.	Jnl.	532	18	11
Dec. 31	To Capital—Proportion of Instalment	Jnl.	783	10	6	1936 Dec. 31	By Depreciation at 10% p.a. on £4,796 10s. 9d.	Jnl.	479	13	1
1936 Dec. 31	To Capital—Proportion of Instalment	Jnl.	822	14	1	1937 Dec. 31	By Depreciation at 10% p.a. on £4,316 17s. 8d.	Jnl.	431	13	9
1937 Dec. 31	To Capital—Proportion of Instalment	Jnl.	863	16	9	1938 Dec. 31	By Depreciation at 10% p.a. on £3,885 3s. 11d.	Jnl.	388	10	5
1938 Dec. 31	To Capital—Proportion of Instalment	Jnl.	907	–	7	1939 Dec. 31	By Depreciation at 10% p.a. on £3,496 13s. 6d.	Jnl.	349	13	4
1939 Dec. 31	To Capital—Proportion of Instalment	Jnl.	952	7	9	,, 31	,, Balance	c/d	3,147	–	2
							(*Note.*—In practice the balance would be carried down annually; the whole amount is treated as cumulative in this example in order to show the agreed cash price)				
			£5,329	9	8				£5,329	9	8
1940 Jan. 1	To Balance	b/d	3,147	–	2						

Entries in the Books of the Elysium Cinemas, Ltd. (*Contd.*)

Dr. **MACHINE HIRE ACCOUNT** *Cr.*

			£	s.	d.				£	s.	d.
1935 Dec. 31	To Hire of Talking Picture Machines for the year .	Jnl.	216	9	6	1935 Dec. 31	By Transfer to Profit and Loss Account . . .	Jnl.	216	9	6
1936 Dec. 31	To Hire of Talking Picture Machines for the year .	Jnl.	177	5	11	1936 Dec. 31	By Transfer to Profit and Loss Account . . .	Jnl.	177	5	11
1937 Dec. 31	To Hire of Talking Picture Machines for the year .	Jnl.	136	3	3	1937 Dec. 31	By Transfer to Profit and Loss Account . . .	Jnl.	136	3	3
1938 Dec. 31	To Hire of Talking Picture Machines for the year .	Jnl.	92	19	5	1938 Dec. 31	By Transfer to Profit and Loss Account . . .	Jnl.	92	19	5
1939 Dec. 31	To Hire of Talking Picture Machines for the year .	Jnl.	47	12	3	1939 Dec. 31	By Transfer to Profit and Loss Account . . .	Jnl.	47	12	3

Inclusion in Balance Sheet.

The debit balance standing on the asset account, i.e. the "Talking Pictures Machine Account" in the example, is included in the Balance Sheet as "Instalment(s) paid on Talking Pictures Machines on Hire Purchase." This leads us to the consideration of a contention which is often put forward that the full liability should be shown in the published accounts. There is a good deal to be said for this argument, and those secretaries who agree with it usually adopt one or other of the following courses—

1. The inclusion of a note in the Balance Sheet as to the total commitment under the hire-purchase agreement.

2. The insertion of the full amount payable under the agreement, from which is deducted the proportion paid to the date of each particular Balance Sheet.

3. Entering in the books of account themselves the full cash value of the asset and the corresponding full liability to the vendors. The interest is then added annually to the vendor's account.

There are theoretical objections to two of the above suggestions, but from a practical point of view there is nothing against their adoption.

The Seller's Records.

The records kept by vendors of goods on hire purchase may be extremely simple or very elaborate, according to whether they are merely incidental to the main business or whether the transactions are numerous.

If they are few in number then they are dealt with as under—

1. The cash value of the goods is debited to the purchaser and credited to Hire Purchase Sales Account.

2. Interest is debited to the purchaser's account at the due date of each instalment, the corresponding credit

being made to "Interest" or "Hire Purchase Interest Account."

3. At the end of the year the "Hire Purchase Sales Account" is transferred to the credit of Trading Account, and the "Hire Purchase Interest Account" is transferred to the credit of Profit and Loss Account.

4. The total debits appearing on the accounts of the purchasers are shown in the Balance Sheet as "Debtors under Hire Purchase Agreements," but a reserve is created to meet any losses which may arise as a result of default on the part of the hirers.

It will be seen that the procedure outlined above amounts to the converse of the entries made by the buyer which we considered earlier in the chapter. Under these circumstances it is not necessary to illustrate the method at length by examples.

Alternative Method.

Where the hire-purchase transactions are numerous a special Hire Purchase Day Book is kept. The sales are entered in this day book at cost and then posted periodically—in totals only—to the debit of a total account called "Hire Purchase Account," and to the credit of "Goods sent out on Hire Purchase." This latter account is transferred, at balancing time, to the credit of Trading Account.

In addition to the foregoing a Memorandum Ledger is opened for the personal accounts of the hirers who are debited with the total amounts due from them under the agreements and credited with the instalments as and when paid. It assists in the compilation of this Memorandum Ledger if the Day Book is ruled with two columns recording the full selling price as well as cost.

The Cash Book is arranged to show the total periodical receipts from the hire purchasers, and these totals are posted to the credit of the Hire Purchase Account.

The effect of these entries will be seen at once if we assume, for a moment, that a given set of transactions were completed simultaneously exactly at the end of a year. There would be a credit balance on the Hire Purchase Account representing the profit on the sales made, including the interest content. This balance would be transferred to the credit of Profit and Loss Account as "Profit on Hire Purchase Agreements." The transfer of the cost of the goods from "Goods sent out on Hire Purchase" to the credit of Trading Account would then close the matter.

In actual practice, of course, the foregoing circumstances do not arise on account of the fact that there will always be a number of uncompleted transactions outstanding. This entails the valuation of the stock in trade in the hands of hire purchasers.

Stock in the Hands of Purchasers.

At balancing time the various personal accounts appearing in the Memorandum Ledger are extracted on to sheets of columnar paper. These schedules, when completed, show the original debit against each hirer, the instalments paid and the balance outstanding. In the final column is inserted the value of the stock at the balancing date, at cost. This will not be the original cost portion of the total price, because every item will be found to have been partly paid for by the customers. The cost is therefore computed with due regard to the number of instalments paid and to the number still to be received.

When the total value of the stock has been ascertained it is credited to Hire Purchase Account and carried down as the opening stock for the new period. The balance remaining on Hire Purchase Account then represents the net profit or loss for the period and is transferred to Profit and Loss Account.

EXAMPLE. The Ajax Co., Ltd., sells sewing machines

on hire-purchase terms. The following items appear in its books and schedules for the year ended 31st December, 1933—

	£	s.	d.
(*a*) Sales for the year at Cost . . .	52,382	10	–
(*b*) Cash received from Hire Purchasers during year	15,220	5	–
(*c*) Balances to debit of Purchasers for Memorandum Ledger	43,275	–	–
(*d*) Unearned Profit included in "C". . .	4,903	11	–

It is required to show the Hire Purchase Accounts in the ledger, and these are set out on page 315.

Return of Goods Hired.

The usual hire-purchase agreement permits the vendor to take possession of his goods should the hirer default in the payment of his instalments. In such an event the outstanding interest will, of course, not be earned, and must be written off the books if it has been brought into account in any way. In addition, the debt due from the hirer, less the proceeds of the goods returned and resold as second-hand, will fall to be charged in the accounts as a bad debt, or set off against the reserve built up to meet such losses.

"The Option Payment."

Reference must be made, before concluding the chapter, to the "option payment agreement." This type of agreement is of fairly recent origin. It consists of an undertaking on the part of the hirer to pay hire for the subject-matter of the agreement at a rate which, multiplied by the term, would amount to the total hire under the more usual form of agreement. Then follows a condition that for a further payment, usually a nominal sum of 1s. or £1, the hirer may purchase the subject-matter outright. Where this class of agreement is in force it will be found customary to disregard the option payment clause, and to treat the whole agreement in the same way as an ordinary hire purchase

THE AJAX CO., LTD.

Dr. **HIRE PURCHASE ACCOUNT** *Cr.*

1933			£	s.	d.	1933			£	s.	d.
Jan. 1	To Stock in hand of Hire Purchasers	b/d	—	—	—	Dec. 31	By Cash received from Customers	C.B.	15,220	5	—
Dec. 31	,, Goods sent out on Hire Purchase	H.P. Jnl.	52,382	10	—	,, 31	,, Stock in the hands of Customers at Cost	c/d	38,371	9	—
,, 31	,, Net Profit transferred to Profit and Loss A/c	Jnl.	1,209	4	—						
		£	53,591	14	—			£	53,591	14	—
1934 Jan. 1	To Stock in the hands of Customers	b/d	38,371	9	—						

Dr. **GOODS SENT OUT ON HIRE PURCHASE** *Cr.*

1933			£	s.	d.	1933			£	s.	d.
Dec. 31	To Transfer to Trading Account	Jnl.	52,382	10	—	Jan. 1 to Dec. 31	By Goods sent out to Customers during the year	H.P. Jnl.	52,382	10	—
		£	52,382	10	—			£	52,382	10	—

contract. This course can safely be adopted by the secretary because, although legally the sale of the goods should not be credited to Trading Account until the option is exercised, the arrangement is—in practice—no different from the more normal ones with which we have been dealing. The option clause can, therefore, be regarded as an additional safeguard to the seller rather than as a matter which need disorganize the accounting in any way.

SELF-EXAMINATION QUESTIONS. XXIII

1. Distinguish between hire purchase and instalment buying, and explain the differences in the accounting entries recording each type of transaction.

2. What is the Interest Suspense Account? What purpose does it serve?

3. A gas company deals in stoves on the hire purchase system. On 1st January A. purchased a stove for 55s. to be paid for in twelve equal instalments of 4s. 7d. each. The stove cost the gas company 37s. 6d.

The first four quarterly instalments were duly paid. How should these transactions appear in the gas company's Ledger so that each year is credited with its proper proportion of profit earned, ignoring depreciation.—(*Chartered Accountants.*)

4. On 1st March the B.S. Coal Co. obtained wagons on the hire purchase system at a price of £1,150. Payment was to be made as to £150 down and as to the balance at £200 per annum with 5 per cent interest.

The B.S. Coal Co. write off 10 per cent depreciation each year. Construct the necessary ledger accounts in the books of the company, showing the entries in detail.—(*Incorporated Accountants.*)

5. The Hard Coal Colliery Co., Ltd., agreed to purchase from the International Wagon Co., Ltd., 100 railway wagons, at the price of £50 per wagon, paying for the same by half-yearly instalments of £300, such instalments to include interest on the unpaid purchase money at the rate of 7 per cent per annum.

The date of the purchase was 1st January, and the first half-yearly instalment was due 1st July.

Write up the Hard Coal Colliery Co.'s Account in the Wagon Co.'s books for three years, and also write up the Wagon Account in the Colliery Co.'s books for the same period.—(*Chartered Accountants.*)

SECTION IV

THE PREPARATION AND PRESENTATION OF ACCOUNTS

In this section the preparation and presentation of the annual accounts of companies will be considered. This includes the study of the compilation of accounts under the Double Account System and similar matters which are frequently treated as special systems of book-keeping and accountancy.

The Secretary's Duties.

Reference was made in the Preface to the fact that the time when the secretary left the drawing-up of the Trial Balance and Accounts to the auditors is rapidly passing away. It is now necessary to remark that whilst this state of affairs represents a commendable step forward there is room for a still greater advance on the part of the company secretary. This further step is the general acceptance of the duty of preparing the annual accounts in completed form, subject only to modification by the Board and to approval by the auditors.

It is true that in a great number of public companies the secretary does complete the accounts and, in fact, presents a first printed draft to the auditors on the commencement of their work. But these cases, compared with the total number of joint-stock companies in England, form a very small minority.

The Form of the Balance Sheet.

It is probable that no great improvement will occur until the practical force of the statement that "the accounts are the accounts of the directors" is realized. The theoretical truth of this point is fully accepted,

but its practical acceptance will only be universal when it is realized that the directors cannot act in this matter except through their chief officer, the secretary. This means that not only the preparation of a draft Balance Sheet but also the choice as to its form is actually, if not theoretically, the work of the secretary.

It is not suggested for a moment that the secretary can claim the last word in the form or appearance of the annual accounts. Neither is it suggested that there need be any conflict of opinion between the secretary and the auditors as to the treatment of any given item. All that is suggested is that the company secretary could, if he chose, take a very much greater part and responsibility in the preparation of the final Balance Sheet than he does to-day in the vast majority of cases.

Present Practice.

Present practice with regard to the preparation of accounts varies to a considerable degree as between various companies. A limited number of secretaries, as mentioned above, do carry the matter right through. Others content themselves with a roughly drawn balance sheet in which the requirements of the Companies Act are inadequately complied with, or in which they are completely neglected. In these cases, as also in the cases in which the work is taken only to the Trial Balance, the responsible work is left to the auditors. This often comprises the calculation of reserves, the ascertainment of contingent liabilities, and the preparation of schedules of debtors and creditors as well as the compilation of the accounts for the approval of the directors.

It is submitted that the present practice is indefensible, and in the following pages there will be found indicated an outline of the minimum duties which the student of secretarial work should regard as falling within his sphere.

CHAPTER XXIV

THE ANNUAL ACCOUNTS OF COMPANIES

As soon as the Trial Balance has been taken out and agreed the secretary should have fair copies drawn up together with neat schedules of the debtors, the creditors, the banking accounts together with the reconciliation statements, and so on. The reserves and accounts should then be calculated carefully and listed. It is also a good plan—but not an essential one—to have schedules typed out in duplicate showing the movements on the fixed assets and liabilities since the date of the last accounts. All these papers should then be bound up in two sets, one of which should be handed to the auditors on their arrival.

The other set will prove of inestimable value to the secretary during the Board meeting held to discuss the draft accounts. He will be able to answer any questions raised by the directors as to the composition of certain items, or as to the changes which have arisen in the company's position since the last meeting.

The Draft Accounts.

The draft accounts should be made up by the secretary as nearly as possible in the form in which he considers they should be published. This course should be followed irrespective of whether the company is a private or a public one. There are, of course, many statutory requirements attaching to the accounts of a public company which do not apply to a private one. Nevertheless, if the secretary prepares his draft accounts as though, in every case, they were completely subject to the statutes, he will find that he is setting himself a sound standard.

It is recommended that every secretary should prepare a schedule of all points which he should take

into account in preparing his accounts. Each list will naturally vary with the particular circumstances, but a general indication of the contents is given below.

Statutory Considerations.

The first part of the schedule should be devoted to the possible statutory obligations placed on the company in connection with its accounts. If it is subject to its own special act or charter, or if it is a company governed by some enactment as the Building Societies Act, 1894, then, of course, such legislation will form the basis. If it is an ordinary company, then the requirements of the Companies Act, 1929 as to accounts will be set down. Considerations of space prevent the quotation of these requirements *in extenso*, but the following references will guide the secretary in the preparation of his own list. It will be observed that the references are given in the normal order of the Balance Sheet and Profit and Loss Account.

Subject-matter	*Reference*	*Subject-matter*	*Reference*
Authorized Capital	Sect. 46	Shares and Debentures in Subsidiary Companies	Sect. 125
Issued Capital	,, 46	Debts due from Subsidiary Companies	,, 125
Redeemable Shares	,, 54	Loans to Directors and Officers	,, 128
Capital carrying Int.	,, 54	Loans to Employees for Purchase of Shares	,, 45
Debentures and Redeemed Debentures	,, 75	Preliminary Exps.	,, 124
Trade Creditors	,, 124	Expenses of Issue of Capital or Debentures	,, 124
Secured Creditors	,, 124	Commission paid on Shares and Debentures	,, 44
Debts to Subsidiary Companies	,, 125	Discount on Debentures	,, 44
Reserves, General or Funds	,, 123	Discount on Shares	,, 47
Capital Redemption Reserve Fund	,, 46		
Fixed Assets, Land, Buildings, Goodwill, etc.	,, 124		
Floating Assets, Debtors, etc.	,, 124		

Subject-matter	*Reference*
Notes as to Guarantees given by Company of Loans to Directors or Officers	Sect. 128
Statement as to treatment of Profits and Losses of Subsidiaries	,, 126

The references given above are only intended to guide the secretary in preparing his own list. It must also be remembered that there are legal points surrounding practically each one. It is beyond the province of this present volume to explain them, but they must nevertheless be taken into account in drawing up the guide, and the student is therefore earnestly advised to furnish himself with a copy of the *Law of Joint Stock Companies* (Pitman) before undertaking the preparation of his list.

Other Considerations.

Having listed the statutory obligations relating to his company's accounts, the secretary should then schedule the general matters requiring attention. These will include such points as the following—

1. The summarizing of contingent liabilities under—
   (*a*) Guarantees.
   (*b*) Partly-called investments in companies.
   (*c*) Pending legal actions.
   (*d*) Forward contracts.
   (*e*) Bills under discount.
2. The inclusion of all necessary reserves, including provision for taxation and for special reserves stipulated in the company's articles.
3. The calculation of commissions payable on net profits to managers or the directors.

This list could, of course, be continued indefinitely, but as it must be framed to suit the requirements of each particular company no purpose would be served in attempting to compile an exhaustive schedule. Enough has been given to indicate the type of adjustments which should receive the secretary's personal attention and not—as is so often the case—left to the auditors.

A " Pro Forma " Example.

We will conclude the chapter with an illustration of

THE SUCCESS CO., LTD.

TRIAL BALANCE—31st DECEMBER, 1935

	Debit		Credit	
	£	£	£	£
1. Land and Buildings		145,000		
2. Plant and Machinery (and Depreciation)		263,888		26,388
3. Fixtures		39,444		3,944
4. Goodwill, Patents, and Trade-marks		12,200		
5. Issued 5% Preference Share Capital Account			250,000	
6. Issued 6% Preference Share Capital Account, Redeemable			50,000	
7. Issued Ordinary Share Capital Account			400,000	
				700,000
8. Trade Debtors per Schedules of S.L. Balances		113,495		
9. Loan to Mr. Jameson, director, as at 1st January, 1935		2,500		
10. Loan to Mr. Smithers, director, made during year and repaid		3,500		3,500
11. Investments in quoted securities, less reserve to bring to quoted prices		87,725		2,225
12. Reserve Account				145,200
13. Capital Redemption Reserve Fund				50,000
14. Investment in the A B Subsidiary Co., Ltd.	23,000			
15. Investment in the C D Subsidiary Co., Ltd.	22,000			
		45,000		
16. Debentures in the A B Subsidiary Co., Ltd.		12,000		
17. Current Accounts with the E F Subsidiary Co., Ltd.		13,400		22,400
18. Rates Account—Reserve for amount paid in advance		105		
19. Stock-in-Trade at 31st December, 1935		150,490		
20. Cash at Lloyds Bank, Ltd.		144,010		
21. Preliminary Expenses Account		9,200		
22. Trade Creditors per Schedules of B.L. Balances				25,200
23. The X Y Co., Ltd., Loan secured by deposit of Investments				10,500
24. Rent Account—Rent of Siding accrued due				3,200
25. Mr. Walton, cash creditor—Temporary Deposit				1,500
26. Loan to Mr. Benson, director, as at 1st January, 1933, repaid 31st January, 1935		1,000		1,000
27. Profit and Loss Account—Balance per separate account				47,900
		£1,042,957		£1,042,957

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7. Invest in E.F.

Item No. in T.B.	Subject	Remarks	Section of C.A., 1929
1	Land and Buildings	Fixed asset, therefore show basis of valuation	124
2	Plant and Machinery	As above	As above
3	Fixtures	As above	As above
4	Goodwill, etc.	As above, if ascertainable	As above
6	Redeemable Shares	Show date of redemption.	46
8	Trade Debtors	Prepare full schedules showing dates incurred and whether since paid	—
9	Loan, Jameson	Must be shown because not repaid during the year	128
10	Loan, Smithers	Must be shown because made this year	128
11	Investments	Prepare schedules showing exact whereabouts, etc.	—
13	Capital Redemption Reserve Fund	Must be shown as a separate item	46
14 } 15 }	Holdings in Subsidiaries	Show in aggregate only	125
16	Debentures in Subsidiaries	Advisable to show separately	—
17	Current Accounts with Subsidiaries.	Set out on separate sides of Balance Sheet.	125
21	Preliminary Expenses	Show separately until written off	124
23	Secured Creditor	Show separately, but do not specify the asset charged.	124
26	Loan, Benson	No need to show because repaid during year and was outstanding at beginning	128

THE SUCCESS CO., LTD.

DRAFT BALANCE SHEET as at 31st DECEMBER, 1935

LIABILITIES	£	£
Share Capital:		
Authorized—		
250,000 5% Preference Shares of £1 each	250,000	
100,000 6% Redeemable Shares of £1 each	100,000	
500,000 Ordinary Shares of £1 each	500,000	
		850,000
Issued—		
250,000 5% Preference Shares, fully paid	250,000	
50,000 6% Redeemable Preference Shares, fully paid	50,000	
(Redeemable at the Company's option on or before 31st December, 1940)		
400,000 Ordinary Shares, fully paid	400,000	
		700,000
Sundry Creditors and Apportionments—		
Trade Creditors	25,200	
Secured Creditors	10,500	
Amounts due to Subsidiary Companies	22,400	
Other Creditors	1,500	
Reserves for Expenses accrued	3,200	
		62,800
Reserve Account as at 1st January, 1935		145,200
Capital Redemption Reserve Fund		50,000
Profit and Loss Account		47,900
		£1,005,900

ASSETS	£	£
Fixed Assets—		
Land and Buildings—at cost	145,000	
Plant and Machinery—at cost, *less* Depreciation	237,500	
Fixtures—at cost	35,500	
Goodwill, Patents, and Trade-marks—at cost	12,200	
		430,200
Floating Assets—		
Trade Debtors	113,495	
Shares in Subsidiary Companies	45,000	
Debentures in Subsidiary Companies	12,000	
Amounts owing by Subsidiary Companies	13,400	
Payments in Advance	105	
		184,000
Loans to Directors as at 1st January, 1935	2,500	
Add Further Advances	3,500	
	6,000	
Less Repayments	3,500	
		2,500
Investments at quoted prices		85,500
Stock-in-Trade		150,490
Cash at Bankers		144,010
Preliminary Expenses as at 1st January, 1935		9,200
		£1,005,900

the preparation of a Balance Sheet for presentation to a board of directors. It will be observed that whilst it is described as a draft due consideration has been given to the various points mentioned above. It follows that the auditors will only be called upon to audit and not to take part in any way in the preparation of the accounts. This arrangement is perfectly correct although, naturally, the board will take full cognizance of any suggestions raised by the auditors and, if they think fit, give effect to them in the final draft.

For the sake of simplicity the Profit and Loss Account is given in one figure only. This will prevent the obscuring of the much more important points connected with a limited company's Balance Sheet.

The secretary first completes the Trial Balance as shown on page 322, and then turns to his list of statutory and other points requiring consideration. His notes would be set out somewhat as shown on page 323.

The notes are not intended to be exhaustive. In practice, the secretary would go much further and make notes, for example, as to any commission paid on shares or expenses of issues of capital. These would call for treatment as indicated in earlier chapters. In addition, he would prepare draft summaries of the losses or profits of subsidiaries (Sect. 126), and such matters as guarantees of loans to directors, etc. (Sect. 128).

Having exhausted all these points he would proceed to compile the Balance Sheet on the lines shown on page 324.

CHAPTER XXV

THE "DOUBLE ACCOUNT" SYSTEM, "BANK ACCOUNTS," "INSURANCE ACCOUNTS," ETC.

THE double account system is a method of presenting the annual accounts of companies which are subject to special statutes such as the Regulation of Railways Act, 1868, the Gas Works Clauses Act, 1871, and the Electric Lighting Acts. In addition, the system is adopted widely by other companies which, though not governed by the statutes, are public or semi-public service undertakings, e.g. Telegraph and Cable Companies, Canal, Dock, Water, and Tramway Companies.

Meaning of "Double Account."

The title "double account" arises from the fact that the Balance Sheets of the companies concerned are divided into two parts; they are, in fact, double accounts. The first part shows the fixed assets acquired by the undertaking and the capital and debentures which have been raised for the acquisition of those assets. This part of the Balance Sheet is known as the "Capital Account," and the balance appearing on it is carried down to the second part, which is known as the "General Balance Sheet."

The General Balance Sheet follows the usual form except, of course, that it will include balances peculiar to statutory companies, e.g. amounts due to or from Clearing Houses, etc.

Division of the Capital Account.

The Capital Account is prepared in three-column form. On the debit or expenditure side the first column shows the outlay up to the end of the preceding year, whilst the second column gives the expenditure for

the year under review. The third column is the total column. On the credit or receipts side the columns record the total capital or debentures subscribed to the end of the previous year, the receipts for the current year and, then again, the total.

Discounts or premiums arising on the issue of shares or debentures are treated as part of the capital account, and are deducted or added, as the case may be, in the first section of the Balance Sheet.

Depreciation and Renewals.

It is a feature of the double account system that the assets acquired out of the capital shown in the Capital Account shall be maintained at their cost. The renewals of worn-out assets are charged to revenue account. In this way it can be seen exactly how the original capital and the subsequent increases have been sunk in the fixed assets shown in Part I, Capital Account. In practice, it is usual to find a departure from the strict letter of the statutes in the matter of renewals. It is not always convenient to allow the full charge for any given year's renewals to fall in that year's accounts. The companies therefore build up Depreciation Accounts and Repairs and Renewals Reserves in order to equalize the charges to Revenue Account.

"Pro Forma" Example.

On page 328 will be found a *pro forma* example of a Balance Sheet drawn up on the double account system. The student should study the illustration carefully in conjunction with the foregoing, noting the division of the Balance Sheet into two parts, from which the title "Double Account" arises.

The Books of Account.

It will be realized that the ordinary principles of double entry are followed by "double-account"

Example of "Double Account" Balance Sheet

THE EASTERN RAILWAY CO., LTD.

RECEIPTS AND EXPENDITURE ON CAPITAL ACCOUNT

To Expenditure	Amount Expended to 31st Dec., 1936	Amount Expended during Year	Total	By Receipts	Amount Received to 31st Dec., 1936	Amount Received during Year	Total
	£	£	£		£	£	£
Lines Open for Traffic	110,400	5,000	115,400	Shares	100,000	55,000	155,000
Lines Jointly Leased	20,000	1,000	21,000	Loans	3,000	1,000	4,000
Total Expended on Railway	130,400	6,000	136,400	Debenture Stock	55,000	—	55,000
Electric Stations	10,000	2,000	12,000	Balance of Premiums and Discounts	—	—	1,400
Steamboats	14,000	3,000	17,000		—	—	£215,400
Total Expenditure	£154,400	£11,000	£165,400				
Balance carried to General Balance Sheet	—	—	50,000	Balance carried to General Balance Sheet	—	—	—
	—	—	£215,400		—	—	£215,400

GENERAL BALANCE SHEET

	£		£
Capital Account, Balance at credit thereof	50,000	Cash at Bankers	30,000
Creditors	10,000	Investments in British Government Securities	10,500
Superannuation Funds	12,000	Other Investments	10,500
General Reserve	20,000	Stocks of Material	5,000
Balance available for Dividends	5,000	Clearing House	11,000
		Miscellaneous Accounts	30,000
	£97,000		£97,000

companies. The only departures from the usual system are to be found in matters of detail such as, for example, in the method of keeping the accounts relating to the fixed assets. These are maintained at cost in order to conform with the manner in which the annual Balance Sheet is presented.

Bank Balance Sheets.

The principal feature of a bank Balance Sheet is that the order of its assets differs from that ordinarily adopted by a trading or manufacturing concern. Instead of showing them in the order of their permanence, they are marshalled according to their liquidity, the cash coming first, followed by investments, then bills, and the fixed assets appearing last. The student should examine the *pro forma* example given on page 330 and note the application of the above principle.

In view of the nature of a bank's business, i.e. dealing only in cash, investments, and instruments of credit, the preparation of its accounts is comparatively simple. There are no questions of stock valuations (except investments) or complicated problems of work-in-progress and depreciation to be dealt with. The only special points to observe are that all proper reserves have been brought in, that rebate on bills has been calculated correctly, and that adequate provision has been made against customers' accounts. The following points serve to explain the more important features of the final Balance Sheet—

CAPITAL AND RESERVES. A sub-total is sometimes made under these items, as shown in the illustration, in order to indicate the total interest of the proprietors.

CURRENT AND DEPOSIT ACCOUNTS. This heading covers all amounts due to customers and correspondents and, in practice, other small miscellaneous balances. It is sometimes extended by the words "and Other Accounts," but how far this justifies the inclusion of

THE CENTRE BANK, LTD.

BALANCE SHEET as at 31st DECEMBER, 1936

LIABILITIES	£
Authorized Capital—	
5,000,000 Shares of £5 each	25,000,000
Capital Paid-up—	
5,000,000 Shares of £5 each: £2 paid	10,000,000
Reserve Fund	10,000,000
Balance of Profit and Loss Account	1,622,900
	21,622,900
Current and Deposit Accounts	362,713,100
Acceptances on behalf of Customers	37,552,500
	£421,888,500

ASSETS	£	£
Cash, Bank-notes, and Balances with Bank of England		54,900,000
Balances with other Bankers in Great Britain		14,600,100
Money at Call or Short Notice		16,200,900
Investments—		
British Government	40,200,100	
British Corporation Stocks	501,300	
Other Quoted Securities	142,600	
		40,844,000
Bills Discounted		62,382,900
		188,927,900
Advances to Customers		190,322,100
Liabilities to Customers on Acceptances *per contra*		37,552,500
Bank Premises, Head Office and Branches		5,086,000
		£421,888,500

reserve accounts and large miscellaneous balances is a question for consideration.

ACCEPTANCES. It will be noticed that this liability is offset exactly by a claim on the assets side against the customers for whom the bank has accepted drafts and bills of exchange. These bills are distinct from the bills bought by the bank in the course of trading and which are shown as "Bills Discounted."

REBATE ON BILLS. The profit made by the bank on its dealings in bills is represented by the discount. At balancing time a number of the bills will not have matured, and the interest unearned is therefore calculated and reserved in the Profit and Loss Account as "Rebate on Bills not yet due."

MONEY AT CALL AND SHORT NOTICE. This asset represents advances made from day to day, or for periods not exceeding seven days, to stockbrokers or the Money Market. It will be noticed that it is treated as the next liquid item after balances with other bankers.

The Trial Balance and the "Slip System."

The trial balance from which the bank Balance Sheet is prepared is not a lengthy document. It is true that the mass of detail is very great; but as all the customer's balances, being similar in nature, appear as two or three items only, the trial balance consists of little more than an amplified list of the final assets and liabilities. Of course, it is supported by bulky schedules of the bills, the Ledger balances, the investments, and so on. The total accounts, together with the "private" accounts, such as capital, reserves, taxation, and dividend accounts, are kept in the General Ledger, and the whole of the bank's system is framed to furnish all necessary information for keeping these total accounts absolutely up to date. This system is known as the "Slip System," and it will be found used throughout the whole of the bank's organization, including the branches.

The basis of the system is that all entries in the Ledgers are made from the original documents and dockets, or "slips" themselves. Thus the paying-in slips are used by the cashier for debiting the "Received Cash Book," and are then passed to one or other of the Ledger-keepers in order that the corresponding credits may be made in the customers' accounts. Similarly, the cheques drawn by customers are used for making entries in the "Paid Cash Book" and also in the Ledgers. In this way the loss of time which would be occasioned if each clerk had to wait his turn in using the normal type of Day Book is completely obviated.

Semi-Annual Statement.

Under the Companies Act, 1929 (Sect. 131), every banking, insurance, provident, and benefit society has to make out a statement in the form given in Schedule 7 to the Act. This statement must be prepared on the first Monday in February and the first Tuesday in August, and must be displayed in the head office and in every branch. Creditors and members may obtain copies on payment of a fee not exceeding 6d. The principal contents of the statement are—

(*a*) The share capital of the company and the number of shares issued.

(*b*) The calls made on the shares and the cash received in respect thereof.

(*c*) The liabilities, setting out the debts under classifications.

(*d*) The assets, distinguishing between investments in Government securities, bills of exchange, cash, and other securities.

Insurance Accounts.

The preparation of the annual accounts of insurance companies is governed to a great extent by the

Assurance Companies Act of 1909. Under this Act the assuring companies have to deposit £20,000 with the Paymaster-General in respect of every class of business carried on, the interest on such deposits being regarded as part of the respective funds to which they relate. It is provided that no deposit need be made in respect of fire or accident business if the company has already made deposits for life and employers' liability business.

Annual Accounts.

The Act stipulates that the company shall prepare, at the end of each year, the following accounts—

1. A "Revenue Account," according to the form set out in the first schedule to the Act, according to the type of business carried on.

2. A "Profit and Loss Account" according to the form set out in the second schedule to the Act.

3. A "Balance Sheet" according to the form set out in the third schedule.

First Schedule.

The First Schedule is given in different forms marked "A," "B," "C," and so on, applicable to life, fire, accident, employers' liability, and bond investment business, etc., respectively. The general principle upon which they are framed is much the same, and illustrations of two forms only are given, those for life and fire. It will be observed that in both cases the form shows the amount of the fund at the beginning of the year, and the manner in which it has increased or decreased during the year under review. The illustrations are given on pages 334 and 335.

The Balance Sheet.

The Balance Sheet (Schedule 3) follows a set form, in which the assets are marshalled in the given order

First Schedule

(*A*) FORM APPLICABLE TO LIFE ASSURANCE BUSINESS

REVENUE ACCOUNT OF THE.....FOR THE YEAR ENDING.....

	Business within the United Kingdom	Business out of the United Kingdom	Total		Business within the United Kingdom	Business out of the United Kingdom	Total
	£	£	£		£	£	£
Amount of Life Assurance Fund at beginning of Year . .				Claims under Policies Paid and Outstanding—			
Consideration for Annuities Granted				By Death . . .			
Interest, Dividends, etc., *less* Income Tax . . .				,, Maturity . .			
Other Receipts . . .				Surrenders, including Surrenders of Bonus . . .			
				Annuities . . .			
				Bonuses in Cash . . .			
				Bonuses in Reduction of Premiums			
				Commission			
				Expenses of Management .			
				Other Payments . . .			
				Amount of Life Assurance Fund at the end of the Year			
£				£			

(*B*) FORM APPLICABLE TO FIRE INSURANCE BUSINESS

REVENUE ACCOUNT OF THE.....FOR THE YEAR ENDING.....

	£	£		£	£
Amount of Fire Fund at the beginning of the Year			Claims under Policies Paid and Outstanding		
Reserve for Unexpired Risks .			Commission		
Additional Reserve, if any .			Expenses of Management . .		
Premiums			Contributions to Fire Brigades .		
Interest, Dividends, etc., *less* Income Tax			Other Payments		
			Amount of Fire Fund at the end of the Year		
Other Receipts					
£			£		

of (*a*) mortgages; (*b*) loans; (*c*) investments; (*d*) agents' balances, etc.; (*e*) bills receivable; and, lastly, (*f*) cash and other assets. The liabilities consist of (*a*) capital; (*b*) the funds according to the forms given under Schedule 1; (*c*) Sinking Fund; (*d*) Profit and Loss Account; (*e*) claims which have to be paid; and, lastly, (*f*) amounts due to creditors. The position of the Sinking Fund and the Profit and Loss Account may appear unusual, but the reason is clear if the illustration given on page 337 is examined. It will be observed that a sub-total is made underneath the funds and the capital accounts. This enables a quick comparison to be made between the amounts due to outside creditors and the assets, and also between the capital accounts and the assets.

The Profit and Loss Account.

The Profit and Loss Account of insurance companies, Schedule 2, resembles the Revenue Accounts in that the sides are reversed as compared with the normal commercial account. There is no generally accepted explanation for this peculiarity except perhaps that it is due to the fact that the schedules as well as the Act itself were drafted by lawyers.

The account need not be prepared unless the company transacts more than one class of insurance business. If one class only is transacted, then the Revenue Account relating to that class is regarded as sufficient. The entries in the Profit and Loss Account are as follows—

PROFITS (*Left-hand Side*)

1. Realized profits shown on each of the Revenue Accounts. These surpluses are transferred to the Profit and Loss Account.

2. Any extraordinary or general profits not applicable to any particular Revenue Account.

INSURANCE COMPANY'S BALANCE SHEET

THIRD SCHEDULE

BALANCE SHEET OF THE.....ON THE.....19.....

LIABILITIES	£	£	ASSETS	£
Shareholders' Capital, paid up			Mortgages on Property in United Kingdom	
Life Assurance Funds—			Mortgages on Property outside United Kingdom	
Ordinary Branch			Loans on Parochial and Other Rates	
Industrial do.			,, on Life Interests	
Annuity Fund			,, on Reversions	
Fire Insurance Fund			,, on Stocks and Shares	
Accident Insurance Fund			,, on Company's Policies within Surrender Value	
Employers' Liability Insurance Fund			,, on Personal Security	
Bond Investment Fund			Investments—	
Marine Insurance Fund			Deposits with the High Court	
Sinking Fund and Capital Redemptio. Fund			British Government Securities	
Profit and Loss Account			Municipal and County Securities	
Other Funds, if any			Indian and Colonial Securities	
			Foreign Government Securities	
Claims Admitted, but not yet paid—	£		Railway and Other Debentures	
Life Assurance			Railway and Other Preference Stocks	
Fire Insurance			Rent Charges	
Bond Investment, etc.			Leasehold Ground Rents	
			House Property, etc.	
Annuities due, but unpaid			Agents' Balances	
Other Sums owing by Company			Outstanding Premiums	
			Outstanding Interest and Dividends	
			Bills Receivable	
			Cash—On Deposit	
			,, —On Current Account	
	£			£

LOSSES (*Right-hand Side*)

1. Deficiencies transferred from the Revenue Accounts.
2. Any special losses not chargeable to particular Revenue Accounts.
3. Dividends and bonuses paid to shareholders.
4. Any extraordinary expenses which cannot be allocated to particular Revenue Accounts.

Ascertainment of Profits.

The profits (surpluses) or losses (deficiencies) arising on the Revenue Accounts are arrived at by ascertaining the company's liability under each heading, and then setting this liability off against the accumulated funds. In the case of life assurance, an actuarial valuation is made at least once in five years. This valuation gives the total liability in respect of current policies and also the present value of the premiums receivable. From these figures the appropriate reserve is calculated and entered in the Revenue Account. The balance on the account is then transferred to Profit and Loss Account.

In the case of fire and similar business, it is not possible to work to actuarial valuations. It is therefore customary to create a reserve based on past experience. When ascertained, this reserve, which is expressed as a percentage of the premium income, is entered in the Revenue Account. The balance, representing profit or loss, is then transferred to Schedule 2 in the ordinary way.

CHAPTER XXVI

THE ACCOUNTS OF SUBSIDIARY AND HOLDING COMPANIES

PRIOR to 1929 there were no statutory provisions as to the manner in which one company's holding in another should be shown in the annual accounts. In the Companies Act of 1929, however, provisions were inserted requiring the disclosure of certain particulars regarding the interest of holding companies in their subsidiaries. The clauses dealing with this matter are Sections 125, 126, and 127, the substance of which is as follows—

(*a*) The aggregate interest of a holding company in subsidiary companies must be set out in the Balance Sheet, and the interest must be analysed as between shares and indebtedness. (Sec. 125.)

(*b*) Indebtedness on the part of the parent company to its subsidiaries shall also be set out in the Balance Sheet of the holding company separately from its other liabilities. (Sec. 125.)

(*c*) To the Balance Sheet of the holding company there must be annexed a statement, signed by the directors who sign the Balance Sheet, showing how the aggregate profits or losses of the subsidiary companies have been dealt with in the accounts of the parent company. In particular, it must be disclosed how the losses of the subsidiaries have been dealt with, or how they have been taken into account by the directors in arriving at the holding company's profit. (Sec. 126.)

(*d*) If there are any qualifications in the reports of the auditors of the subsidiaries, then those qualifications must be disclosed in the Balance Sheet of the parent company.

Meaning of Subsidiary.

The definition of a subsidiary company is set out in Section 127, which provides that a company shall be regarded as a subsidiary, if—

1. The parent company holds more than 50 per cent of the issued share capital of the subsidiary or such shares as to entitle it to more than 50 per cent of the voting power.
2. The parent company has power directly or indirectly to appoint a majority of the directors to the board of the subsidiary.

It is laid down that a company shall not be regarded as a subsidiary merely because another company exercises control by reason of the powers conferred by a debenture trust deed, or by reason of the fact that its shares are deposited with another company as security for money lent.

The Accountancy View.

It will be appreciated that the statutory provisions outlined above have not resulted in the publication of details with regard to subsidiaries which can be regarded as really informative to the shareholders of the parent company. Nevertheless, the provisions of the Act must be followed out carefully, and the secretary must keep close watch to see that his company publishes the formal information called for under the statute.

It may so happen that the directors decide to deal with the matter from the accounts point of view and to present informative accounts to the shareholders. This may be effected either by submitting summaries of the accounts of the subsidiaries with the main Balance Sheet, or by preparing a consolidated Balance Sheet of the whole undertaking. The secretary must always be conversant with this work, whether it is intended to publish the combined Balance Sheet or not. Only by the regular examination of such an account can a board of directors keep its finger on the pulse of a combine's affairs, and the secretary should

therefore endeavour to have a consolidated Balance Sheet available at every possible meeting of his Board.

The Wholly Owned Subsidiary.

The consolidation of Balance Sheets will be easily understood if the matter is taken in stages. The simplest example will therefore be examined first. This is the case of a company owning the entire share capital of a subsidiary, and for the shares of which it subscribed at par. It will be appreciated that in such circumstances the Share Capital Account of the subsidiary will equal exactly the cost of the shares in that subsidiary appearing in the Balance Sheet of the parent company as an investment. If a consolidated Balance Sheet were prepared, the various assets in the parent company would be added to the similar assets in the subsidiary, but the investment in the subsidiary would be ignored. In the same way, the liabilities would be added together, except that the share capital of the subsidiary would also be left out of account and treated as a *contra* to the investment mentioned above.

EXAMPLE

THE "X" PARENT CO., LTD.—BALANCE SHEET

	£		£
Capital	500,000	Freehold Land	250,000
Creditors	100,000	Machinery	150,000
Reserve Account	50,000	Stock	50,000
Profit and Loss Account	50,000	Debtors	100,000
		Cash	50,000
		Investment in the "Y" Subsidiary Co., Ltd.—at Cost	100,000
	£700,000		£700,000

THE "Y" SUBSIDIARY CO., LTD.—BALANCE SHEET

	£		£
Capital	100,000	Freehold Land	50,000
Creditors	50,000	Machinery	60,000
Profit and Loss Account	10,000	Stock	10,000
		Debtors	40,000
	£160,000		£160,000

THE CONSOLIDATED BALANCE SHEET

	£		£
Capital	500,000	Freehold Land	300,000
Creditors	150,000	Machinery	210,000
Reserve Account	50,000	Stock	60,000
Profit and Loss Account	60,000	Debtors	140,000
		Cash	50,000
	£760,000		£760,000

Shares Purchased at a Premium, etc.

The next stage to consider is the case of a parent company holding shares in a subsidiary or subsidiaries purchased otherwise than at par. If the shares were purchased at a premium, then such premium will figure in the consolidated Balance Sheet as "Goodwill." Thus, in the example given above a purchase price of £150,000 for the shares in the "Y" Co., Ltd., would result in the appearance of a Goodwill Account for £50,000 in the consolidated Balance Sheet.

Should there be any surplus of assets in the subsidiary at the date of purchase, then such surplus may be deducted from Goodwill Account in the combined Balance Sheet. The surplus usually takes the form of Reserve Accounts or accumulations of profit on Profit and Loss Account.

In the event of a deficiency of assets in the subsidiary, an addition will be made to goodwill to the extent of the deficiency when preparing the consolidated accounts.

Companies Partly Owned.

The case of the partly-owned subsidiary is slightly more difficult. There are two recognized methods of incorporating such subsidiaries into the consolidated Balance Sheet of the group. Firstly, each asset and liability may be apportioned between the parent company and the outside shareholders, and only the amount due to the former brought into the combined account. This method is not often adopted on account

of the complications which arise in calculating the parent company's share of composite assets and of the reserves belonging to one or more class of shareholder.

The second method is to amalgamate the Balance Sheets in the usual way, but to treat the interest of the outside shareholders, in the capital and the reserves, as a liability.

EXAMPLE. The "X" Parent Co., Ltd., whose Balance Sheet is identical with that given in the previous example, has an interest in the "Y" Co. to the extent of two-thirds of the share capital only. The Balance Sheet of the "Y" Co., Ltd., includes Share Capital, £150,000; Reserve Account, £40,000; Cash at bankers, £90,000; whilst the remainder of the assets and liabilities are the same as those given in the first illustration. The consolidated Balance Sheet would then appear as follows—

THE CONSOLIDATED BALANCE SHEET

	£		£
Capital	500,000	Freehold Land	300,000
Creditors	150,000	Machinery	210,000
Reserve Accounts	76,667	Stock	60,000
Share Capital in Subsidiary held by Outside Shareholdrs.	50,000	Debtors	140,000
Liability to Outside Shareholders in Subsidiary—		Cash at Bankers	140,000
Proportion of Reserve	13,333		
Proportion of Accumulated Profits	6,667		
Profit and Loss Account	53,333		
	£850,000		£850,000

Capital Reserves.

Occasionally it will be found that the assets of the subsidiary have been revalued for the purpose of arriving at the price to be paid by the parent company for the shares, but that the asset accounts have not been adjusted in the Ledger. If so, the secretary is at liberty to bring the assets of the subsidiary into the consolidated Balance Sheet at the written-up values. On the other side of the Balance Sheet he introduces

a Capital Reserve Account, of which the appropriate portion due to outside shareholders, if any, is allocated as usual.

Stock in Trade.

Care must be taken to see that stocks bought from one company in a group by another company are not brought into the combined accounts at a price including unrealized profit. Such profit must be reserved against, a corresponding reduction being made from the Profit and Loss Account.

Some companies apportion this profit reserve as between outside shareholders and the parent company, and allow the amount applicable to the former to stand. There is no objection to this course in theory, but it will be found more convenient in practice to exclude all unrealized inter-company profit from the consolidated accounts.

Preference Shares.

Preference shares sometimes carry a right to participate in surplus assets on a winding up. Whether a proportion of the surplus assets should be allocated to outside preference shareholders who hold such shares is an undecided question. As the consolidated account is intended to show the position of the combine as a going concern, it is perhaps preferable to treat such shares as a liability at par.

Deficiencies.

Deficiencies of assets may rightly be apportioned between the parent company and the outside holders of ordinary shares. It is true that the latter cannot be called upon to contribute their share of the deficiency. At the same time an erroneous view of the position of the parent company might be conveyed if all ordinary shares were not treated identically.

Conclusion.

The secretary should remember that he is always liable to meet with fresh problems in the preparation of consolidated accounts. So much depends upon the circumstances of each case, that it is impossible to lay down a series of set rules for dealing with all cases. He will find that no serious complication of any sort arises if the whole of the capital of the subsidiary or subsidiaries is owned by his company. It is only when third parties have an interest in them that any difficulty presents itself. And even then he will surmount them if he takes care always to see that the interests of such outside parties are fully reflected in the combined accounts he lays before his board of directors.

APPENDIX

"GOODS ON CONSIGNMENT" AND "GOODS SENT TO BRANCHES"

Reference was made in Chapter XX to the fact that there is an alternative method of dealing with "Goods sent on Consignment" Account. The same remark applies to the "Goods sent to Branches" Account dealt with in Chapter XXI.

It is held that at balancing time the stock-in-trade held by the consignee should be debited to the "Goods sent on Consignment Account," and carried down as a credit balance. The same amount should also be carried down in the "Consignment Account" as shown on page 259. The debit balance on "Consignment Account" and the credit balance on the "Goods sent on Consignment Account" are then treated as contras in the Trial Balance. Lastly, the stock-in-trade is valued in the ordinary way, included in the stock in trade schedules as usual, and then entered as a credit balance in the Trading Account.

Applying the above alternative procedure to the example given on pages 259 and 260, we get the following result—

1. "Goods on Consignment Account" debited, at 30th June, 1936, with stock carried down £549.

2. The balance remaining on "Goods on Consignment Account," viz. £451 (£900 less £549) transferred to the credit of Trading Account.

3. The balance carried down to the credit of the "Goods on Consignment Account" under (1) above, £549, is set off against the similar balance appearing on the "Consignment to the Ganges Co., Ltd.," shown on page 259.

Dr. TRADING ACCOUNT FOR THE YEAR ENDED 31st DECEMBER, 1936 *Cr.*

	£	£
By Sales for the Year (say)	422,680	
,, Goods on Consignment	100,000	
		522,680
,, Stock-in-trade (say)		12,408
		£535,088

Under the alternative method the foregoing would be shown as under—

Dr. TRADING ACCOUNT FOR THE YEAR ENDED 31st DECEMBER, 1936 *Cr.*

	£	£
By Sales for the Year	422,680	
,, Goods on Consignment	10,000	
		432,680
,, Stock-in-trade	12,408	
,, Stock in the hands of Consignees.	90,000	
		102,408
		£535,088

4. The stock-in-trade in the hands of the consignees is then included with the general stock-in-trade of the A.B.C. Manufacturing Co., Ltd.

The particular advantage claimed for this method is that it does away with the entry of misleading figures in the Trading Account. For example, if a company sends goods valued at £100,000 on 1st January, 1936, to a consignee who manages to sell only £10,000 worth by the end of the year, then the entries in the accounts under the method given in Chapter XX would be as shown on page 332.

The choice between the two methods is optional, but the secretary will find that the particular circumstances of each case constitute the deciding factor. In the case of goods sent to branches, for instance, it may happen that regular monthly or weekly consignments have been disposed of, and that the stock in hand at balancing time is comparatively small. In such a case there can be no objection to crediting the whole turnover as "Goods sent to Branches."

On the other hand, if it is a single consignment which is being treated, and only a small proportion has been sold, it is probably preferable to adopt the alternative method.

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